Annual Report 1978

FOOD FAIR, INC. Fiscal Year ended July 29, 1978

CORPORATE OFFICERS

GRANT C. GENTRY
Chairman, President
Chief Executive Officer

ROGER L. GALASSINI
Vice President
General Counsel

JOHN T. GRIGSBY, JR.
Vice President
Chief Financial Officer

FRANK N. JAMES
Vice President
Chief Operating Officer

WILLIAM H. McCHESNEY
Vice President—Accounting

GERALD NATHANSON
Vice President

DARRELL V. STIFFLER, JR.
Vice President
Director of Industrial Relations

NEIL THALL
Vice President
Director of Management Information Services

LEO DICANDILO
Treasurer

HOWARD F. GORDON
Secretary
Assistant General Counsel

MICHAEL MANDELBLATT
Assistant Treasurer

EDMOND O'NEILL
Assistant Secretary

HARVEY RICHARDS
Assistant Secretary

LEONARD STUBINS
Assistant Secretary

DIRECTORS

ROBERT B. ANDERSON
Attorney, Business Consultant

JOSEPH L. CASTLE
Management and Financial Consultant

GEORGE FRIEDLAND
Investor

ROGER L. GALASSINI
Vice President and General Counsel of the Company

GRANT C. GENTRY
Chairman, President and Chief Executive Officer of the Company

JOHN T. GRIGSBY, JR.
Vice President and Chief Financial Officer of the Company

FRANK N. JAMES
Vice President and Chief Operating Officer of the Company

GERALD NATHANSON
Vice President of the Company

JAMES J. NEEDHAM
Business Consultant

COMMITTEES

EXECUTIVE COMMITTEE
Grant C. Gentry, *Chairman*
Roger L. Galassini
John T. Grigsby, Jr.
Frank N. James

AUDIT COMMITTEE
James J. Needham, *Chairman*
Robert B. Anderson
Joseph L. Castle

EXECUTIVE COMPENSATION COMMITTEE
Grant C. Gentry, *Chairman*
Robert B. Anderson
George Friedland
James J. Needham

EXECUTIVE OFFICES 3175 John F. Kennedy Blvd. Philadelphia, Pa. 19101

AUDITORS Touche Ross & Co. 1700 Market Street Philadelphia, Pa. 19103

STOCK TRANSFER AGENTS Registrar & Transfer Company 34 Exchange Place Jersey City, N.J. 07302

REGISTRAR The Chase Manhattan Bank N.A. 1 Chase Manhattan Plaza New York, N.Y. 10015

3175 John F. Kennedy Blvd., Philadelphia PA 19101 (215) EV 2-9500

Grant C Gentry
President and
Chief Executive Officer

Food Fair, Inc.

To: Food Fair Shareholders

Instead of the usual annual report for the fiscal year ended July 29, 1978, we are providing you with the more detailed Form 10-K filed with the Securities and Exchange Commission (SEC). We believe the additional information you will find in this report is more appropriate at this time than the traditional annual report and is consistent with your management's intention to keep shareholders fully informed about the affairs of the Company.

The audited financial figures confirm the preliminary results previously issued to shareholders showing the Company incurred a net after-tax loss of $52.5 million on sales of $2.8 billion. In view of this loss for the year and the fact that a small profit was reported for the first three quarters, at my request, current senior management, assisted by the international accounting firm of Touche Ross & Co., has completed a review to determine the effects of certain 1978 fiscal year adjusting journal entries on previously reported unaudited quarterly financial information.

In a letter to the Company, (Exhibit D to the 10-K), Touche Ross concludes that while material portions of adjustments recorded in the fourth quarter of the year pertain to earlier periods, it may be impossible to determine how those adjustments should be allocated to the first three quarters, given the condition of the Company's system of internal accounting controls in 1978 and the nature and magnitude of adjustments made at year end. The Company is taking steps to correct deficiencies in its system of internal accounting controls.

We have also enclosed separately a copy of the Form 10-Q report filed with the SEC which sets forth the unaudited results for the first 28 weeks ended February 10, 1979, of the current fiscal year. Again, we believe that this report is more appropriate than the customary interim shareholders' report.

For the 28-week fiscal first half, the Company incurred a net loss of $117 million. Of that loss, $15 million came from continuing operations (of which a substantial portion was incurred prior to January 1, 1979), $60 million from closed supermarkets and support facilities, and $42 million for the discontinued J.M. Fields division.

The first half loss, which includes certain non-recurring adjustments combined with the effect on net worth of the retroactive capitalization of leases amounting to $39 million, resulted in a negative net worth as of February 10 for the Company of $67 million.

We are presently discussing the formulation of a proposed debt settlement plan with the Company's creditors' committees. It is management's expectation that any plan which is developed will return the Company to a positive net worth position. The proposed plan will require approval by a majority of creditors who have filed proofs of claim both in number and amount and must be approved by the bankruptcy court and possibly, depending upon its nature, by shareholders.

Shareholders are familiar with the Company's filing of petitions for an arrangement under Chapter XI of the Bankruptcy Act on October 2, 1978. Reasons for this action were explained in the petitions and summarized in letters to shareholders dated December 19, 1978, and February 22, 1979. Since filing, major steps have been taken to restore the Company to profitability. These have included the termination of unprofitable supermarket operations and our discount department store division.

An in-depth study of the Company's operations and financial condition, in conjunction with the Touche Ross management consulting group, made it abundantly clear that these actions were necessary if the Company were to survive. In addition to the substantial reduction of our retail operations, we have closed or will close certain other non-retail activities which were either unprofitable or too marginal to continue in the Company's present circumstances. In this category are our two meat slaughtering plants and one meat fabricating plant.

Certain profitable manufacturing operations—our coffee, tea and soft drink plants—as well as Washington Square Life Insurance Company and our Footwear Services operation—will be retained.

The paring of unprofitable operations with the resultant loss of jobs of many co-workers was a painful but necessary process to insure the viability of the Company.

We are, in point of sales, far less than half the size we were before Chapter XI. But, more importantly, the sales generated from our continuing operations have been historically profitable. These operations—in Baltimore, Norfolk-Richmond, Jacksonville and Miami—have contributed $77 million in pre-tax operating profits over the last five fiscal years. However, it is anticipated that the summer reporting periods for these on-going operations will be unprofitable because of normal summer sales reductions and actions the Company has taken to strengthen our supermarket operations for the following fiscal year.

In the Baltimore Region, for example, a major merchandising program has been launched with the thrust on lower prices, in an effort to re-establish our market share. Concurrently, a strong promotional program has been undertaken in Virginia in conjunction with a name change of our stores in the area from Food Fair to Pantry Pride. The costs of the promotions in both of these areas and the costs involved in the name-change in Virginia, will have a temporary impact on supermarket operating earnings. However, we believe these moves will be beneficial in strengthening our competitive position in both marketing areas and improving their profitability prospects for the next fiscal year.

As I noted previously, we are confident that the most painful and costly actions required in the Company's reorganization are now behind us and that we can devote our efforts to building the new and revitalized Food Fair.

In that effort, we have been heartened by our creditors' committees action of approving the resumption of construction of three supermarkets in Florida which had been halted at the time of the Chapter XI filing. Their approval of the funds required to open these stores reflects their confidence in the Company's future and its management.

With the completion of the Company's reorganization and in anticipation of the proceeds from the liquidation of inventories and the sale of leases of closed facilities and owned properties, we intend to present a plan of arrangement respecting our debt to creditors in the near future. We are hopeful that the plan will be approved before the end of 1979 and that we shall then be able to operate our business without the constraints of Chapter XI.

For your further information, I wish to advise that the Company repaid early a $28 million loan with $2.4 million interest to certain secured creditors. This payment was made without prejudice so that the Company, any creditor or any other party in interest can raise at any time the issue of whether the payment should have been made. By making such repayment, the Company has been able to save over $100,000 per month in interest charges.

In building for the future, I should like to bring to shareholders' attention several personnel changes and appointments at the senior management level.

Frank N. James, formerly vice president-administration, has been appointed chief operating officer of the Company and president of the Pantry Pride Supermarket Division. Mr. James, whose career with Food Fair spans more than 30 years, succeeds as supermarket division president, Marvin N. Lerner, senior vice president, who resigned as an officer and director in March.

John T. Grigsby, Jr. has been elected vice president and chief financial officer and director. Mr. Grigsby, formerly a management consultant with Touche Ross, succeeds John R. Lilly, who resigned.

Roger L. Galassini has been elected vice president and director and will serve as the Company's general counsel. William H. McChesney has been named vice president-accounting, a new position. Both men have had many years of experience in their professions and in food chain operations.

Neil Thall has been elected vice president-management information services, and John V. Marra has been appointed controller.

We have been successful in recent weeks in bringing to our board of directors three individuals who have distinguished themselves in business and government: James J. Needham, Robert B. Anderson and Joseph L. Castle. Mr. Needham was formerly chairman and chief executive of the New York Stock Exchange and a commissioner of the Securities and Exchange Commission; Mr. Anderson is a former Secretary of the Treasury and business executive; Mr. Castle is a financial consultant to business, with extensive prior experience in investment and commercial banking. We intend to add other outside directors of stature from whose counsel the Company can benefit.

I am also pleased to report that Touche Ross & Co. has been appointed the Company's independent auditors.

I joined Food Fair on January 4, 1979, as chairman, president, and chief executive officer with a firm resolve to restore the Company to a profitable status and establish the foundation for sound, future growth. At the same time, I am determined through a strict enforcement of Company policies with respect to dealings with suppliers to prevent allegations like those currently being investigated of transactions between the Company and business related to the prior management.

In August 1978, the audit committee of the Company's board of directors initiated such an investigation based on allegations in a business magazine. With the institution of Chapter XI proceedings and the resignation from the board of the audit committee members, the work started by the audit committee has been continued by the creditors' committees with the support and endorsement of present management. The bankruptcy court authorized retention of the international accounting firm of Price Waterhouse & Co. to assist the creditors' committees in carrying forward this investigation. More recently, the reconstituted audit committee, comprised of Messrs. Needham, Anderson and Castle, has reassumed its involvement in these proceedings.

Your present management is appreciative of the encouragement of shareholders in our continuing efforts to make Food Fair once again a strong, profitable Company and will keep you informed of our progress.

Sincerely,

Grant C. Gentry
Chairman/President
Chief Executive Officer

June 29, 1979

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Fiscal Year Ended	Commission File No.
July 29, 1978	1-2956

FOOD FAIR, INC.

(Exact name of Registrant as specified in its charter)

Pennsylvania	23-1172640
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employee Identification No.)

3175 John F. Kennedy Boulevard, Philadelphia, Pennsylvania 19101

(Address of Principal Executive Office)

Registrant's telephone number, including area code: (215) 382-9500

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered*
8⅜% Sinking Fund Debentures Due January 15, 1996	None*
4% Subordinated Debentures Due April 1, 1979	Philadelphia Stock Exchange*
Common Stock, $1 par value	Philadelphia Stock Exchange* Pacific Ccast Stock Exchange*

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed with the Commission by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

Yes ________ No x

7,358,277

Number of Shares of Common Stock Outstanding as of July 29, 1978

*See "Delisting of Securities" under Item 1.

Item 1. *Business*

Food Fair, Inc. (which, together with its subsidiaries is hereinafter sometimes referred to as the "Company") presently operates a chain of retail food supermarkets in the Baltimore, Maryland, Norfolk-Richmond, Virginia and Jacksonville and Miami, Florida areas under the names "Pantry Pride", "Food Fair Quality Discount" and "Food Fair", and related food manufacturing and processing businesses which supply the supermarket store division, as well as make sales to third parties. The Company also operates certain related non-food retail, wholesale and manufacturing operations, and conducts various miscellaneous operations, including a life insurance company. Some of the Company's non-retail operations make sales to other divisions of the Company as well as to third parties. Since October 2, 1978, the date petitions were filed under Chapter XI of the National Bankruptcy Act (see "Chapter XI Arrangement Proceedings" below), the Company has terminated its supermarket operations in the Pennsylvania, New York, Connecticut, and Tampa, Florida areas, has discontinued operations of its J.M. Fields general merchandise discount department stores and is in the process of closing its meat processing operations.

CHAPTER XI ARRANGEMENT PROCEEDINGS

On October 2, 1978, the Company and nine of its subsidiaries including J. M. Fields, Inc., Hills Supermarkets, Inc. (then operating certain supermarkets in the Long Island, New York area) and Newcorp Supermarkets, Inc. (then operating certain supermarkets in the Philadelphia area) filed petitions under Chapter XI of the Bankruptcy Act with the Clerk of the United States District Court for the Southern District of New York and the cases were referred for all purposes to Bankruptcy Judge John J. Galgay (hereinafter referred to as the "Court") seeking an arrangement of their respective indebtedness and liabilities. (Index Nos. 78 B 1764-1773). (See Report on Form 8-K dated October 10, 1978, with respect to events occurring October 2, 1978.) On that date, the Court issued its order authorizing the filing corporations to continue operations as debtors-in-possession.*

During the late spring of 1978, a shortage of working capital and increasingly late payments to suppliers resulted in the imposition by suppliers of increasing restrictions on the availability of credit terms. These restrictions in turn resulted in serious understocking conditions at many of the Company's stores, with a resulting adverse impact on revenues and profitability. In order to bolster trade credit, the Company, in June 1978, initiated discussions with its principal bank lenders with a view to obtaining a short-term $28 million loan to assist in the reduction of overdue trade payables and to obtain restoration of trade credit availability. Negotiations for this loan were protracted and the funds were not made available until August, 1978. During this period supplier relationships were strained, and despite substantial payments to suppliers after the loan was funded, normal credit terms continued to be denied to the Company, worsening the out-of-stock conditions at many stores and leading to an erosion of customer goodwill, with further adverse impact on sales and working capital. The Company also found itself unable to extend short-term bank loans as they fell due, and, between the end of the fiscal year, July 29, 1978, and October 2, 1978, paid off $3,300,000 of such loans, further eroding the Company's working capital position. On the date of the filing of the Chapter XI petition, an additional $700,000 of such loans were to become due without prospect of extension. Estimated losses from operations were believed by then to have reduced the Company's net worth below that required to be maintained under the Company's loan agreements with certain lenders. For this as well as other reasons, all of the Company's institutional indebtedness would likely have become immediately due under the terms thereof, in which event the Company would be faced with the prospect of having its bank accounts set off against outstanding indebtedness.

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* The proceedings in Chapter XI for Food Fair, Inc. and its subsidiaries have been procedurally consolidated and are being jointly administered under Docket 78-B 1764 under the caption "In Re J. M. Fields, Inc., et al, Debtors" and are hereinafter referred to collectively as the "Chapter XI Proceedings".

Based upon the information currently available to the Company, its indebtedness immediately prior to the filing of its Chapter XI petition on October 2, 1978 included:

Trade Debt:	$186,243,000
Banks and Other Institutions:	140,735,000
Public Debt:	41,659,000

The Company's liabilities presently are in excess of the aggregate of those set forth above. (See "Significant Events Subsequent to October 2, 1978" below.)

In its petition for an arrangement under Chapter XI, the Company cited, as the reasons for its financial difficulties (a) the parent company's advances to Fields, over the past three to five years, of in excess of $100,000,000 to cover losses sustained by the Fields chain, (b) the emergence of increased competition in traditionally strong supermarket areas, (c) the cash drain caused by Fields, which left insufficient cash availability in the supermarket divisions to purchase inventories in sufficient quantity to obtain maximum discount levels and increased gross profit margins, (d) loss of volume in the supermarkets by reason of their inability to fully stock and thereby effectively compete with competitors, (e) inability to obtain normal credit terms from suppliers and (f) the existence of internal administrative problems which may have resulted in lack of accurate accounting controls.

The Company has advised the Official Creditors' Committees that it plans to put forth a plan of arrangement ("Plan") with respect to its pre-Chapter XI unsecured obligations. A Plan will require the approval of a majority of the Company's creditors in number and amount, and must, among other things, be shown to the Court to be feasible and in the best interests of the creditors within the meaning of the Bankruptcy Act. Should the Company be unable to formulate a Plan, or should a Plan not be accepted by creditors or confirmed by the Court, the Company could be adjudged a bankrupt and its assets liquidated, or the Chapter XI proceedings could be transferred to proceedings under Chapter X of the Bankruptcy Act, in which case control would pass to a court-appointed trustee. The Company has agreed to extend the time within which the Securities & Exchange Commission is permitted, under the Bankruptcy Act and Rules of Bankruptcy Procedure, to move in Court for a transfer to Chapter X.

Significant Events Subsequent to October 2, 1978

Since the commencement of the Chapter XI proceedings, significant changes have occurred in the business, management and operations of the Company. These include: (i) the resignation of certain members of former management and the appointments of Grant C. Gentry as Chairman of the Board, President and Chief Executive Officer, and of other new executive officers (See "Management Changes" below); (ii) the retention of Touche Ross & Co., an international accounting and management consulting firm, to assist management in its design of a viable operating structure for Food Fair and to make recommendations relative to internal operating and financial controls; (iii) the termination of all supermarket operations in the New York and Connecticut, Pennsylvania and Tampa, Florida areas, resulting in the closing of an aggregate of 212 stores (see "Terminated or Discontinued Operations" below); and (iv) the discontinuance of the J.M. Fields discount department store operations.

On May 25, 1979, the Company, with the authorization of the Court, repaid in full the $28 million secured loan, together with approximately $2.4 million of accrued interest, which the Company had obtained in August, 1978 from certain bank lenders.

Current senior management, assisted by Touche Ross & Co., has completed a review to determine the effects of certain 1978 fiscal year adjusting journal entries on previously reported unaudited quarterly financial information. Based upon the results of this review and consistent with the conclusions of Touche Ross & Co., it is apparent that the unaudited 1978 quarterly financial information previously issued by the Company was inaccurate, and further that it would be impracticable, if not impossible, to restate that information. Management is continuing to consider the issue of why such inaccuracies occurred.

The conclusions of Touche Ross & Co. referred to above are set forth below and should be read in connection with its letter of April 25, 1979, which is attached hereto as Exhibit D and should be read in its entirety.

"Conclusions

Based on our discussions and our reading of certain documents including the 1978 quarterly financial statements on Form 10-Q and closing journal entries and underlying analyses for certain journal entries and the conclusions contained in the aforementioned report of Laventhol & Horwath regarding deficiencies in internal accounting control, we have the following observations and conclusions:

A. The deficiencies in internal accounting control during 1978 reported by Laventhol & Horwath were such that there can be no reasonable assurance that 1978 quarterly financial information issued by the Company is reliable. Consistent with the findings of Laventhol & Horwath, we have observed, in the course of our consulting activities, the difficulties experienced by client personnel in attempting to correct or validate information which was prepared in error, apparently because of the same deficiencies.

B. The condition of the system of internal accounting control and the nature and magnitude of the adjustments summarized elsewhere herein signify that material portions of adjustments recorded in the fourth quarter of the fiscal year ended July 29, 1978 pertain to earlier periods.

C. It may not be possible to restate the previously reported quarterly results or the results for the year ended July 29, 1978 since many of the employees who participated in the preparation of the previously issued financial information and underlying accounting records are no longer employed by the Company. In addition, we have been informed by present employees that they frequently are unable to locate documents supporting recorded accounting entries. Also, as a result of the condition of the internal reporting systems and the state of maintenance of the accounting records, Laventhol & Horwath explained in their report that they were unable to perform all of the auditing procedures that they considered necessary to complete their examination of the financial statements as of and for the year ended July 29, 1978. In view of the foregoing factors, we believe reconstruction of available records to appropriately restate previously reported financial results may be impossible."

The Company has taken and is continuing to take affirmative action to remedy deficiencies in its system of internal accounting control so as to eliminate such problems in the future. This action includes employment of new financial management personnel, reconstitution of the Audit Committee of the Board of Directors, restructuring the Company's accounting organization, establishment of a new financial statement review function, and development of a new internal financial reporting package and of an accounting policy and procedure manual.

Results of operations for the twenty-eight weeks ended February 10, 1979 (as reported in the Company's Report on Form 10-Q for the six months ended February 10, 1979 which is incorporated herein by reference) are summarized as follows:

	Continuing Operations	Closed Operations	Total
	(In thousands, except per share data)		
Sales	$ 554,384	$ 443,321	$ 997,705
Loss from continuing and closed operations	$ 14,545	$ 60,021	$ 74,566
Loss from discontinued operations			42,063
Net loss			$ 116,629
Loss per share of common stock:			
Continuing and closed operations	$ 1.98	$ 8.15	$ 10.13
Discontinued operations			5.72
Net loss			$ 15.85

The closed operations include supermarkets and other support facilities closed subsequent to July 29, 1978. Included in the discontinued operations are the 79 J. M. Fields discount department stores and its footwear operations which sold through such stores. Management currently estimates that the proceeds from the disposition of all of the closed and discontinued operations should be at least sufficient to substantially recover costs which include fixed asset-carrying values, costs incurred to maintain these assets prior to disposition, losses from operations during the phase-out period and related disposition expenses. As a result, no reserve has been provided. However, the ultimate gain or loss to be incurred upon disposition is subject to significant uncertainties and possible future adjustments.

Total liabilities of the Company at February 10, 1979, were approximately $746,000,000. The Company's deficiency in assets at February 10, 1979, is as follows (in thousands):

Preferred stock	$ 1,622
Common stock	7,557
Capital in excess of par	51,239
Deficit	(126,478)
	(66,060)
Less cost of common stock in treasury	1,337
	$ (67,397)

In August, 1978, the Company changed its method of accounting for leases to comply with the provisions of Statement of Financial Accounting Standards No. 13 ("FASB 13"). FASB 13 requires the retroactive capitalization of leases and the restatement of financial statements for all years presented. The effect of the accounting change was to decrease retained earnings as previously reported at July 29, 1978 by approximately $39 million. The information relative to leases contained elsewhere in this report does not take into account such retroactive application of FASB 13.

OPERATIONS

At the time of the commencement of the Chapter XI proceedings, the Company was the nation's eighth largest supermarket chain and the sixteenth largest retailer, based upon published statistics, and employed approximately 31,000 people. As a consequence of management's decision to discontinue and dispose of unprofitable operations which resulted in the closing of over half of its supermarkets and to discontinue its J. M. Fields general merchandise discount department stores operations, since July 29, 1978 the Company has been significantly reduced in size.

The following tables set forth certain data with respect to the principal business activities of the Company, for the year ended July 29, 1978. The information is presented in accordance with Statement of Financial Accounting Standards No. 14, "Financial Reporting for Segments of a Business Enterprise." The information set forth in the table for fiscal years ended 1974 through 1977 is presented on the basis of "lines of business," since segment reporting was not required for such years. As a result of the change in reporting requirements, the information presented for 1978 is not comparable to that presented for prior years.

FINANCIAL INFORMATION RELATING TO INDUSTRY SEGMENTS

(In millions)

	Year ended July 29, 1978		
	Supermarket operations	Discount general merchandise operations	Consolidated
Sales to unaffiliated customers	$2,386.4	$399.5	$2,785.9
Operating loss	$ 14.2	$ 18.9	$ 33.1
General corporate expenses			7.4
Interest expense			20.8
Loss from operations before income tax benefit			$ 61.3
Identifiable assets	$ 346.9	$145.0	$ 491.9
Corporate assets			28.4
Total assets			$ 520.3
Depreciation and amortization expenses	$ 18.4	$ 2.7	$ 21.1
Capital expenditures:			
Additions to property and equipment	$ 11.8	$ 1.7	$ 13.5
Capitalized leases	13.1	5.3	18.4
Total capital expenditures	$ 24.9	$ 7.0	$ 31.9

OPERATING RESULTS BY LINES OF BUSINESS

(In millions)

	Year ended nearest July 31:			
	1977	1976	1975	1974
		(52 weeks)		(53 weeks)
Sales:				
Supermarket operations	$1,945.2	$1,962.3	$1,966.3	$1,893.6
Discount department stores	318.8	334.9	317.2	326.3
Other	172.7	209.8	199.0	149.8
Total sales	$2,436.7	$2,507.0	$2,482.5	$2,369.7
Operating profit (loss):				
Supermarket operations	$ 32.0	$ 32.7	$ 30.9	$ 34.7
Discount department stores	(9.8)	(5.2)	(18.4)	(8.1)
Other	(1.9)	(.2)	(.3)	3.5
Total operating profit	20.3	27.3	12.2	30.1
Unallocated expenses:				
Interest	11.5	11.5	13.8	11.9
Corporate overhead	6.3	6.0	5.7	5.1
Total unallocated expenses	17.8	17.5	19.5	17.0
Earnings (loss) before income taxes, discontinued operations and cumulative effect of accounting changes	$ 2.5	$ 9.8	$ (7.3)	$ 13.1

TERMINATED OR DISCONTINUED OPERATIONS

Termination of New York and Connecticut Supermarket Operations

On November 1, 1978, the Court authorized the Company to close 89 supermarkets located in New York and Connecticut. (See Registrant's Report on Form 8-K for events occurring in November, 1978.) During the 1978 fiscal year, the Company's New York-Connecticut supermarket operations accounted for sales of approximately $376,000,000, or approximately 13.5% of the Company's total gross revenues, and sustained a pre-tax net loss, before allocation of corporate overhead and interest expenses, of approximately $12,500,000.

During the three weeks following the Court's authorization, the inventories in these stores were liquidated by a professional liquidator pursuant to an agreement approved by the Court. Gross proceeds of approximately $8,900,000 were realized on this liquidation.

Following the closing of the 89 stores, the Company, with the aid of Stone-East Associates, Inc., and Eastdil Realty, Inc. (a subsidiary of Blyth Eastman Dillon & Co.), real estate brokerage and investment firms whose retention was approved by the Court, initiated a program for the disposition of the real estate, leaseholds and trade fixtures and equipment at the closed locations. The Company owned the residual equity interest in 14 of the 89 locations; the balance being leased from third parties, including Amterre Development Inc. (see "Investment in Amterre Development Inc." below).

As of May 17, 1979, the Company had executed contracts for the sale of 55 leaseholds, and related fixtures, calling for aggregate proceeds of approximately $17,000,000, before expenses of sale, commissions, rent, adjustments, satisfaction of accrued tenancy obligations and related costs. These sales were made to parties making the highest and best offers in sales conducted under the supervision of and subject to the approval by the Court. As of May 17, 1979, 20 supermarket locations in the New York-Connecticut area remained to be disposed of.

The completion of the sale of leasehold interests at 2 locations has been delayed as the result of litigation with the landlords of such premises concerning, among other matters, the Company's right to sell and assign the leaseholds. The Company anticipates that the litigation with landlords will eventually be settled, but is unable to estimate the total cost of such settlements which will vary depending upon, among other things, the terms and conditions of the particular lease involved, the credit-worthiness of the purchaser-assignee, the net proceeds available from the particular sale, the recommendations of the Company's Official Creditors' Committees and determinations by the Court. The Company has received no offers as to 18 leaseholds. If the Company is unable to obtain offers for such locations, the Company intends to sell its trade fixtures and equipment to the highest bidder at an auction sale conducted by an auctioneer approved by the Court, and to disaffirm the leases on such locations. (Under Section 353 of the Bankruptcy Act the Company is permitted to disaffirm outstanding leases and thereby reduce its liability with respect to the remaining terms thereof to an amount not exceeding the rent, without acceleration, reserved by such lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after October 2, 1978, plus unpaid accrued rent, without acceleration, up to the date of surrender or reentry). The book value of the leaseholds and related fixtures heretofore disposed of, including leaseholds as to which litigation with landlords is still pending, was approximately $7,600,000 as at May 17, 1979.

The Company has executed contracts for the sale of 12 properties in which it owns the residual equity interest from which it will realize aggregate proceeds, before expenses, of approximately $8,700,000 over and above first mortgages aggregating approximately $2,900,000, which will be paid on closing. As of May 17, 1979, the net book value of such properties was approximately $5,500,000 (including $1,800,000 of fixtures and equipment). As of May 17, 1979, 2 locations having an aggregate net book value of approximately $734,000 had not been contracted for sale.

Termination of Philadelphia, Harrisburg and Tampa Supermarket Operations

On January 26, 1979, the Court authorized the Company to close its supermarket operations in the Philadelphia and Harrisburg, Pennsylvania and Tampa, Florida regions, comprising a total of 123 stores. (See Registrant's Report on Form 8-K for the month of January, 1979). During the fiscal year ended July 29, 1978, sales of the Philadelphia, Harrisburg and Tampa areas aggregated approximately $600,000,000, or approximately 21.5% of the Company's total gross revenues and such areas substained a pre-tax net loss of approximately $14,650,000 before allocation of corporate overhead and interest.

The decision to terminate operations in the Philadelphia, Harrisburg and Tampa areas was based upon an analysis by management, with the advice of Touche Ross & Co., of all of the Company's operations. These operations were all generating substantial cash losses which the Company could not continue to sustain and had a history of substantial pre-tax losses.

Liquidation of the inventories in the 103 Philadelphia and Harrisburg stores was conducted by a professional liquidator pursuant to an agreement approved by the Court. The Company realized net proceeds of approximately $4,600,000 from the sale of these inventories to the liquidator. The Company conducted its own inventory liquidation at the 20 Tampa stores, realizing net proceeds of approximately $1,380,000.

With the approval of the Court, the Company has retained Stone-East Associates, Inc. and Eastdil Realty, Inc. to assist it in the disposition of the real estate and leaseholds of the closed operations in the Philadelphia, Harrisburg and Tampa areas. It is anticipated that sales will be made to parties making the highest and best offers in sales supervised by, and subject to, the approval of the Court. On March 23 and 29, 1979, 57 of the Company's leasehold interests in the Philadelphia, Harrisburg and Tampa areas were offered for sale in auction proceedings conducted by the Court. Bids for 46 leaseholds were made in these proceedings calling for aggregate gross proceeds, before expenses, of approximately $25,000,000. The Company may reoffer the 11 leases not sold or it may disaffirm the leases. In a number of cases it is anticipated that the Company's sales of leaseholds will be contested by landlords resulting in landlord settlements, as in the case of the sale of leasehold interests in the New York-Connecticut area. The potential cost of such settlements cannot be predicted at this time.

Discontinuation of J. M. Fields General Merchandise Discount Department Stores

On April 17, 1979, the Court authorized the Company to discontinue its J. M. Fields general merchandise discount department stores operation, consisting of 79 department stores located in the eastern United States. These stores have operated at a substantial loss during the past years. In fiscal 1978, the J. M. Fields division had sales of $371,000,000 (including sales of footwear by another subsidiary of the Company), approximately 13.3% of the Company's total gross revenues, and a net loss, before corporate overhead and interest allocations, of $20,400,000. The Company had previously advised the Court on January 26, 1979, of its intention to dispose of the stores. In the intervening period, the Company explored alternative means to accomplish such disposition including sale of the entire operation as a going business. Efforts to find a buyer for the entire division as an operating unit were unsuccessful and, therefore, the Company, with Court approval, ceased operation of the stores and entered into arrangements for the liquidation of the stores' inventory and sale of the related real estate interests and other assets.

The Company sold the J. M. Fields' inventories for 45% of their retail value through a joint venture of two professional liquidators, one of whom previously handled the liquidation of the inventories at the Company's New York, Connecticut, Philadelphia and Harrisburg supermarkets. This inventory at retail value totaled approximately $106 million. After various expenses and adjustments totaling about $5 million, the Company should net approximately $42 million from the inventory liquidation.

With Court approval, the Company has retained Stone-East Associates, Inc. and Eastdil Realty, Inc. to assist in the disposition of the real estate and leaseholds of the closed department store operation. It is anticipated that sales will be made to parties making the highest and best offers in sales supervised by and subject to the approval of the Court. The book value of the real estate and leaseholds attributable to the department store operations was approximately $16,900,000 as of February 10, 1979, not including fixtures and equipment totalling approximately $5,000,000.

Other Prospective Dispositions

Prior to commencement of the Chapter XI Proceedings, the Company operated a kosher cattle and lamb slaughtering and packing plant in Elizabeth, New Jersey under the name Allen Packing Company ("Allen"). During 1978 Allen accounted for gross sales to third parties of $84,760,000. In early October, 1978, however, Allen was completely closed due to the lack of working capital and in late March, 1979, the Company decided to dispose of these assets. As of February 10, 1979, the net book value of fixed assets of Allen was $1,600,000.

On April 6, 1979, the Company ceased operation of Cowan Feeders ("Cowan"), its cattle feedlot operation located approximately 70 miles from Denver, Colorado. As of February 10, 1979, the net book value of Cowan's fixed assets was $653,000.

On April 6, 1979, the operations of the Company's Midtown Veal and Mutton Company ("Midtown"), a meat fabricating plant in Newark, New Jersey were terminated. During 1978, Midtown accounted for gross sales to third parties of $29,800,000. The net book value of the fixed assets of this operation was $871,600 as of February 10, 1979.

The Company has decided to terminate the operations of its Denver meat packing plant, United Packing Company ("United") as of July 28, 1979. During 1978, United accounted for gross sales to third parties of $148,500,000. As of February 10, 1979, the net book value of the fixed assets of United was $1,780,000.

In June, 1979, the Company completed the close down of its northern produce operations. During 1978, these operations accounted for gross sales to third parties of $9,364,000. As of February 10, 1979, the net book value of the fixed assets of such produce operations was $3,000,000.

Although the Company plans to dispose of the assets related to the Allen, Cowan, Midtown, United and produce operations, it does not presently know whether and on what terms these dispositions might be made.

In addition to properties and assets mentioned above, the Company is seeking to dispose of its fee or leasehold interests in over 160 other pieces of real property not presently involved in the Company's ongoing operations. These properties include vacant supermarket locations, warehouse facilities, manufacturing plants, an administrative facility and unimproved real estate located along the eastern seaboard of the United States and in California and the Bahamas. As of February 10, 1979, these properties had an aggregate net book value of approximately $26,800,000 and were subject to mortgages totalling approximately $21,300,000. The Company does not presently know whether and on what terms it will be able to dispose of its interests therein.

All of the various ancillary activities of the Company are being reviewed to determine whether the projected results of their operation over the foreseeable future warrant their retention. This review considers, among other factors, the Company's investment therein, the estimated realizable proceeds upon any disposition, and the Company's overall managerial and systems capabilities and resources.

Application of Proceeds of Asset Dispositions

Funds derived by the Company from sales or other dispositions of its assets or businesses, as described above, are generally required by the Court to be segregated and set aside for ultimate payment to creditors, rather than for use as working capital. (Management presently estimates that the net proceeds from such dispositions may exceed $200,000,000; however, it is premature to make any definitive determination since a significant portion of such businesses and assets have not yet been sold.) In November, 1978, however, the Court ordered that the first $25 million realized from the disposition of the leaseholds, inventories, fixtures and equipment of the New York and Connecticut supermarket operations be set aside in a special trust fund, to secure payment of obligations of the Company incurred subsequent to October 2, 1978, to persons extending trade or other credit. The Court has further authorized payment by the Company of up to $961,638 in severance, vacation and sick pay to former union and non-union employees terminated in connection with the New York and Connecticut area supermarkets. The Court, in its order authorizing the disposition of the supermarkets in the

Philadelphia, Harrisburg and Tampa supermarket areas, permitted the Company to recover from the inventory and other assets sale proceeds thereof, all related expenses. To date the Court has authorized the Company to pay from the sale proceeds an aggregate of $3,581,483 for severance, vacation pay and other fringe benefits for employees terminated as the result of the closing of these stores. Also, with respect to employees terminated as a result of the discontinuation of the J. M. Fields department stores operation, the court has authorized payments from sale proceeds in the aggregate of $1,683,919 for severance, vacation pay and other fringe payments. The foregoing amounts do not include the Company's obligations under various pension plans with respect to the terminated employees, the amount of which obligations the Company presently is unable to precisely estimate. These obligations are presently being reviewed by the Company and independent actuaries.

CONTINUING OPERATIONS

Supermarket Operations

As of June 11, 1979, the Company was operating an aggregate of 210 supermarkets located in Florida (129), Maryland (47), Delaware (7), Virginia (18), Alabama (2), and Georgia (7), as compared to the 442 stores in operation at July 29, 1978. In addition to the 212 stores closed as described above, the Company has also closed an additional 20 stores in the ordinary course of its business since July 29, 1978.

The Company's supermarkets conduct their business on a cash-and-carry basis, selling a broad range of food and other products customarily sold in large American food supermarkets. The stores advertise through local newspapers, radio, television, hand-delivered and mailed circulars and by local promotions on a store-by-store or regional basis.

Virtually all of the Company's supermarkets are free-standing units or part of shopping centers, in most cases with adequate off-street parking adjacent to the store. The remaining few stores are in urban locations without parking facilities. Store sizes generally range from 12,000 square feet to 42,000 square feet. Overall store sizes average 23,000 square feet, with an average selling area of 16,000 square feet. Virtually all of the Company's supermarkets are of the so-called "discount variety" type, emphasizing low prices to the customer and seeking to offset lower gross profit margins with increased sales volume.

Most of the Company's stores have sufficient "backroom" warehousing space to meet day to day restocking needs. In addition, the Company maintains various food distribution centers which, at May 17, 1979, aggregated approximately 1,120,000 square feet. The major distribution centers are located in Jacksonville and Miami, Florida and Baltimore, Maryland.

The Company also operates various food manufacturing and processing facilities. These include facilities for baking, coffee roasting, soft drink bottling and the packaging of tea bags, an artificial cream product and an iced tea mix. The Company's supermarket operation is a major customer for the products of these facilities, although significant sales are made to third parties. Although the recent closing of 229 supermarkets is expected to have an adverse impact on such operations, the Company presently considers them to be viable and intends to retain them.

Other Continuing Operations

The Company, through various subsidiaries (the "Footwear Operation"), presently operates 10 retail shoe outlets in the eastern part of the United States, and also is engaged in the importation and distribution of footwear. Prior to the discontinuance of the Company's J. M. Fields discount department store operations, the Footwear Operation had operated shoe departments in all these stores. Its 1978 retail sales from the Fields stores locations accounted for approximately 63% of its total retail sales volume of approximately $32,000,000 for that year.

Pursuant to exclusive licenses, the Company distributes in the United States footwear under the "Fruit of the Loom" label and children's footwear bearing "Looney Tunes" cartoon character trademarks. The "Fruit of the Loom" license presently expires on December 31, 1980, the Company having recently exercised the first of three two-year options to renew the license; and the "Looney Tunes" license expires June 30, 1981, the Company having the option to extend it for an additional two years. The footwear distributed by the Footwear Division is manufactured to its specifications and is distributed both through a network of 25 distributors and through independent sales representatives. In May, 1978, an 85% owned domestic shoe manufacturing operation, Injection Footwear Company, which had been part of the Company's Footwear Operation was sold for $4,000,000 to an affiliate of Injection's president who was, at that time, the beneficial owner of the remaining 15% interest.

The Company owns all of the outstanding shares of Washington Square Life Insurance Company, a legal reserve life insurance carrier chartered in the Commonwealth of Pennsylvania and authorized to do business in six other states. Washington Square sells a full line of life insurance policies through a staff of licensed agents both to the Company's employees and unaffiliated persons. In the most recent fiscal year approximately 62% of Washington Square's annual premium income was derived from employees of the Company and its subsidiaries. The recent closing of 229 supermarkets and the discontinuance of the J. M. Fields department stores operation may have a material adverse affect on Washington Square, the extent of which cannot be accurately estimated at this time; however, Washington Square to date has remained profitable and the Company presently intends to retain it.

Competition

The Company's supermarkets have generally been located in areas characterized by a high degree of competitiveness among supermarket operators. The Company's supermarket operations are based upon discount merchandising concepts, involving low gross margins intended to be offset by higher sales volume. The supermarket operating areas which the Company has recently terminated operated unprofitably in recent years in large measure because of particularly intense competitive conditions. However, the divisions which the Company intends to retain, while historically profitable, also face considerable competition. Among its major competitors in the areas of continuing operations are Great Atlantic and Pacific Tea Company, Winn-Dixie Stores, Inc., Publix Markets and Giant Stores. The Company has lacked adequate cash and credit resources to support a full-scale program of store modernization and new store openings in its profitable market areas. In order for these areas to maintain their historic levels of profitability, it is essential that the Company have sufficient working capital and access to sufficient financing to permit it to conduct a capital improvements program. There can be no assurance that the Company will be in a financial position to carry out such program.

The Company engages from time to time in promotional activities involving price reductions in its supermarket operations. Competitors of the Company run similar promotional campaigns. A promotional campaign can have adverse effects on profitability locally or nationally depending on the size and financial resources of the competitor running it and its length. Normally, the effects of any such promotion are temporary.

The Company expects it will continue to face the traditional severe competition of the retail supermarket industry, which operates on a high volume, low profit margin basis.

Employee Relations

At April 20, 1979, the Company employed approximately 16,900 persons (which number will be further reduced by an estimated 5,000 persons upon completion of the going-out-of-business inventory liquidation sales at the J. M. Fields department stores) and has contracts with various unions covering wages, hours of employment, and other conditions of employment of certain employees. The Company considers that its labor relations with its ongoing employees and unions are satisfactory.

The Company maintains pension plans for certain of its salaried and hourly-rated employees, and it contributes to various pension plans, maintained by unions, covering certain other hourly-rated employees. At present the Company is unable to precisely estimate the effect the closings and discontinued operations will have on the pension plans and the Company's liabilities thereunder. These liabilities are presently being reviewed by the Company and independent actuaries.

MANAGEMENT CHANGES

On November 13, 1978, Jack M. Friedland, President since 1966, and Chief Executive Officer of the Company since 1971, resigned as an officer and director of the Company. Simultaneously, resignations from the Board of Directors were tendered by Messrs. Samuel Friedland, the founder of the Company, Louis Stein, former Chairman and President, Hess Kline, former Vice-President and Treasurer, and Herman Silver, former Vice-President. In connection with their resignations, Mr.

Friedland and such directors issued statements announcing that their resignations were prompted in part by certain major creditors of the Company and by their desire to remove any obstacles to the successful implementation of a plan of arrangement under Chapter XI. Contemporaneously with such resignations, Marvin Lerner (who subsequently resigned on March 20, 1979) was elected to the position of Senior Vice-President and Chief Operating Officer and served as the senior executive officer of the Company until January 4, 1979, at which time Grant C. Gentry became President, Chief Executive Officer and Chairman of the Board. Mr. Gentry had been a principal of Adamy, Foley and Gentry, Chicago, Illinois, a food industry consulting firm; had previously served for two years as President and Chief Administrative Officer of the Great Atlantic and Pacific Tea Company, a national supermarket chain; and prior thereto had served for 18 years in various positions at the Jewel Companies, Inc., a major regional supermarket chain, ultimately becoming Executive Vice-President. Mr. Gentry has been engaged pursuant to a five-year employment agreement calling for compensation of $350,000 per annum and other benefits. (See Item 15 and Registrant's Report on Form 8-K relating to event occurring January 4, 1979.) Also, since the institution of the Chapter XI Proceedings, the Company has appointed new chief financial, accounting and administrative officers. (See Item 14.)

INVESTIGATION OF RELATED PARTY TRANSACTIONS

In August, 1978, as a result of allegations contained in the August 21, 1978 issue of *Forbes* magazine entitled "Is All Fair at Food Fair?" the Company's Audit Committee undertook an investigation and analysis of certain transactions between the Company and persons or entities affiliated with the Company's management. The Audit Committee retained special counsel and auditors to assist it. On October 4, 1978, each of the directors serving as members of the Audit Committee resigned for the stated reason that he would be unable to devote sufficient time to fulfill his duties as a director of the Company. Subsequent to the formation of the Official Creditors' Committees, such investigation was reactivated, and Price Waterhouse & Co. was retained to conduct it.

The Securities and Exchange Commission has issued an Order of Investigation for the purpose of examining various transactions between the Company and such related or affiliated parties, and to examine the adequacy of the Company's financial reports and disclosures for a period of years prior to the filing of the Chapter XI Petition. (See Items 5 and 15(f) and Note 3 of notes to consolidated financial statements.)

INVESTMENT IN AMTERRE DEVELOPMENT INC

The Company, through a wholly owned subsidiary, F.F. Financial Corporation, which has also filed a petition under Chapter XI (hereinafter "FF Financial"), is the record owner and has certain voting rights, described below, as to approximately 40% (3,333,333 shares) of the outstanding common stock, and all of the outstanding preferred stock, of Amterre Development Inc ("Amterre"), a publicly held developer of shopping centers and other real properties throughout the eastern United States. FF Financial pledged its Amterre shares to a group of lender banks ("Pledgee Banks") in connection with a $28 million secured loan advanced to the Company in August, 1978. The loan was repaid in full on May 25, 1979, but the pledged Amterre shares have not yet been released by the Pledgee Banks.

To date Amterre has not paid any dividends on its common stock. Until September, 1978, Amterre paid aggregate cash dividends on its preferred stock of $120,000 per year. However, as a consequence of the Company's Chapter XI Proceedings, store closings and Amterre's anticipated liquidation, a number of claims and disputes have arisen among Food Fair, Inc., Amterre, and their respective subsidiaries which in turn led the Board of Directors of Amterre to omit payment of the cash dividend on the outstanding Preferred Stock for the last two quarters of 1978 and first quarter of 1979, and may continue to do so. The Company has reached an agreement in principle with Amterre settling such claims and disputes subject to final documentation and approval thereof by the Official Creditors' Committees and the Court.

Until November 14, 1978, when the five directors of the Company referred to above resigned, a majority of the Board of Directors of Amterre were also directors of the Company. At the present time one director of Amterre is also a director of the Company.

On May 2, 1978, the Board of Directors of Amterre voted to recommend to Amterre's shareholders the adoption of a plan of liquidation and dissolution under Section 337 of the Internal Revenue Code (hereinafter referred to as the "Amterre Plan"). The Company is advised that in January, 1979 the Board of Directors of Amterre, after reviewing the status of Amterre's efforts to sell its assets, unanimously confirmed its earlier determination. The Amterre Plan is intended to result in Amterre not incurring any federal income tax liability with respect to the proceeds from the disposition of its assets and would result in the payment by Amterre's shareholders, including the Company, of a single capital gains tax based on the value of the cash and other assets distributed to them. The Amterre Plan would require the distribution to Amterre's shareholders, within 12 months following adoption of the Amterre Plan, of all of its net assets less any amounts required to be set aside in a reserve against contingent or unliquidated liabilities or claims. Should the Amterre Plan be adopted, the Company has been advised that Amterre will seek to sell for cash as many of its assets and properties as possible. The Amterre Plan contemplates among other things, the redemption, at the stated redemption price of $100 per share, of all of the 20,000 shares of Amterre 6% Preferred Stock which are held by the Company. The management of Amterre has publicly announced that it anticipates a liquidating distribution to common shareholders of between $3.00 and $3.50 per share (which would aggregate between $10,000,000 and $11,600,000 for the 3,333,333 shares of Amterre common stock owned by the Company), but there can be no assurance that such estimates will be achieved.

The Amterre Plan requires the approval of a majority of the outstanding shares of Amterre's Common Stock and 6% Preferred Stock, each voting separately as a class. In addition, the Board of Directors of Amterre has determined that the Amterre Plan will not be implemented unless a majority of the outstanding shares of Common Stock, other than the shares owned by the Company or beneficially owned by officers and directors of the Company or Amterre, is voted in favor of the Amterre Plan. Management anticipates that it will vote, or cause the Pledgee Banks to vote, in favor of Amterre's liquidation but has not yet made a definitive decision in this regard. Such decision would require approval of the Official Creditors' Committees and the Court.

On November 21, 1978 a stockholder of Amterre filed suit against Amterre and Amterre's directors and the Company seeking, among other matters, to enjoin Amterre's liquidation. See Item 5.

Amterre operates 50 shopping centers located in Connecticut, Florida, Maryland, New Jersey, New York, Pennsylvania, Virginia and Wisconsin. The Company is presently a supermarket tenant in 9 of such shopping centers; in addition, it remains a lessee of 29 supermarket or department store locations at other Amterre shopping centers which it has vacated, of which 8 have been subleased and 21 are vacant. The Company presently operates 13 supermarkets on separate, free-standing premises owned by Amterre, and also remains a lessee at 38 additional supermarket or department store locations which it has vacated of which 9 have been subleased and 29 are vacant. The Company intends to offer for sale its interest in most of its vacant supermarket and department store locations, including those leased from Amterre and others.

Amterre has informed the Company that it has filed proxy materials with the Securities and Exchange Commission with respect to a meeting of Amterre's common and preferred shareholders to be called for the purpose of considering the Amterre Plan, among other matters. The Company does not know when such meeting will in fact take place. If the Amterre Plan is adopted, the Company has been advised that an initial distribution pursuant to the Amterre Plan may not be expected before approximately six months thereafter.

DELISTING OF SECURITIES

As a result of the Company's filing a petition under Chapter XI, its common stock was delisted on the New York Stock Exchange and suspended from trading on the Philadelphia and Pacific Coast Stock Exchanges, and its 4% Subordinated Debentures and 8⅜% Sinking Fund Debentures were delisted from the New York Stock Exchange and the 4% Debentures suspended from trading on the Philadelphia Stock Exchange. The Company has been informally advised that upon the filing of this report, and any subsequently due reports on Form 10-Q, the Philadelphia and Pacific Coast Stock Exchanges will consider permitting the resumption of trading in the common stock and the Philadelphia Stock Exchange will consider permitting a resumption of trading in the 4% Debentures.

Item 2. *Consolidated Summary of Operations*

(Not covered by accountants' report)

	Fifty-two Weeks Ended				Fifty-three Wks. Ended
	July 29, 1978	July 30, 1977(b)	July 31, 1976(b)	Aug. 2, 1975(b)	Aug. 3, 1974(b)
	(in thousands, except per share amounts)				
Sales	$2,785,899	$2,436,702	$2,507,040	$2,482,539	$2,369,761
Cost of sales	2,252,832	1,943,405	2,010,153	2,006,177	1,905,937
Operating and administrative expenses	580,897	477,600	478,133	469,024	438,663
Income (loss) from operations	(47,830)	15,697	18,754	7,338	25,161
Interest expense, net	(20,758)	(14,603)	(14,776)	(17,325)	(15,512)
Other income	7,294	1,395	5,882	2,725	3,586
Income tax (expense) benefits	8,776	757	(3,284)	4,036	(4,175)
Income (loss) from continuing operations	(52,518)	3,246	6,576	(3,226)	9,060
Equity in loss from discontinued operations of unconsolidated subsidiary, net of income tax benefits(d)			(2,748)	(208)	(134)
Income (loss) before cumulative effect of changes in accounting methods	(52,518)	3,246	3,828	(3,434)	8,926
Cumulative effect on prior years of changes in accounting methods(c)		4,175			
Net income (loss)	$ (52,518)	$ 7,421	$ 3,828	$ (3,434)	$ 8,926
Income (loss) per share of common stock(f):					
Income (loss) from continuing operations	($7.13)	$ .43	$ .88	($.45)	$ 1.20
(Loss) from discontinued operations			(.37)	(.03)	(.02)
Income (loss) before cumulative effect of changes in accounting methods	(7.13)	.43	.51	(.48)	1.18
Cumulative effect of changes in accounting methods		.57			
Net income (loss)	($7.13)	$1.00	$ .51	($.48)	$1.18
Pro forma amounts assuming the 1977 methods of accounting were applied retroactively:					
Income before cumulative effect of changes in accounting methods		$3,246	$6,946		
Per share of common stock		$ .43	$ .93		
Net income		$3,246	$4,198		
Per share of common stock		$ .43	$ .56		
Weighted average number of common shares outstanding during the year	7,358	7,364	7,361	7,380	7,509
Cash dividends per share:					
Common	$ .20	$ .20	$ .20	$ .20	$ .20
Preferred	$ 4.20	$ 4.20	$ 4.20	$ 4.20	$ 4.20

See notes to consolidated summary of operations

NOTES TO CONSOLIDATED SUMMARY OF OPERATIONS
(Not Covered by accountants' report)

(a) The consolidated summary of operations, as it relates to fiscal years 1978 and 1977, should be read in conjunction with the consolidated financial statements, the notes to the consolidated financial statements and the Accountants' Report (consisting of a disclaimer of opinion) of Laventhol and Horwath, all of which are included in Item 12 of this Annual Report on Form 10-K.

The Chapter XI proceedings and related subsequent events and the basis of preparation of the Company's financial statements are more fully described in Note 1 of notes to consolidated financial statements.

(b) During the year ended July 29, 1978 and subsequent thereto, a significant number of facilities owned by Realmart, Inc. (Realmart), an affiliate whose primary business is leasing supermarket facilities to the Company, were closed. Because the closing of facilities has changed the Company's business and investment relationships with Realmart, consolidation of the accounts of Realmart is deemed appropriate. Accordingly, the accounts of Realmart have been included in the financial statements for 1978. This constitutes a change in reporting entity and the 1974 through 1977 consolidated summary of operations have been correspondingly restated. Since in prior years the Company's investment in Realmart was accounted for under the equity method, this restatement has no effect on net income as originally reported.

(c) In the fourth quarter of 1977, the Company changed its methods of accounting as follows: (1) inclusion of warehousing costs in the determination of supermarket inventories; (2) the amortization of payroll tax expense over the entire year; and (3) the computation of deferred income taxes on the gross change method. It was not practicable to determine the effect of these accounting changes for 1976, 1975 and 1974 as presented in the Consolidated Summary of Operations. (See Note 5 of notes to consolidated financial statements.)

(d) The equity in loss from discontinued operations of unconsolidated subsidiary is comprised of the following:

	1976	1975	1974
Equity in loss from discontinued operations of unconsolidated subsidiary	$2,933	$223	$144
Income tax benefit	185	15	10
	$2,748	$208	$134

(e) During the fifty-two weeks ended July 30, 1977, the Company acquired the net assets of 17 supermarkets and the capital stock of a company which operated 43 supermarkets. Both acquisitions were accounted for as purchases; therefore, operations of the acquired supermarkets are included in the Consolidated Summary of Operations from the date of purchase. Proforma combined sales of the Company and the acquired businesses for 1977 approximate $2.6 billion. (See Note 6 of notes to consolidated financial statements.)

(f) Income (loss) per share of common stock is stated after preferred stock dividends and is based on the weighted average number of shares outstanding during each year. Options, warrants and convertible subordinated debt had no significant dilutive effect and primary and fully diluted earnings per share of common stock are the same for the applicable year.

MANAGEMENT'S DISCUSSION & ANALYSIS OF CONSOLIDATED SUMMARY OF OPERATIONS

Due to the circumstances necessitating the filing of Chapter XI petitions on October 2, 1978, management's discussion and analysis of the foregoing Consolidated Summary of Operations should be read in conjunction with Item 1. "Business", and with the consolidated financial statements, the notes to the consolidated financial statements and the Accountants' Report (consisting of a disclaimer of opinion) of Laventhol & Horwath.

1978 Compared to 1977

Sales increased 14.3% or $349.2 million in the year ended July 29, 1978. The increase in supermarket sales, approximately half of the total increase, which represents a 9.4% or $179.0 million increase above prior year supermarket sales, is due to new store openings, the effect of a full year's sales from the Penn Fruit and Hills stores acquired in 1977 and the absence of a strike which adversely affected 1977 sales. Store closings partially reduced the increases enumerated above. (Total stores in operation at the end of 1978 were 442 compared with 490 in 1977.) The increase in discount department store sales, which reflects a 28.0% or $68.0 million increase above the prior year's department store sales, is due principally to planned increases in promotional activities, store layout improvements, and reduction in gross margin which attracted greater customer acceptance. Such sales increases were partially reduced by a shortage of salable merchandise inventories caused by severe liquidity problems and the failure of many suppliers to continue to extend normal credit terms during the latter part of fiscal 1978. The remaining sales increase experienced by the Company, representing a 35.4% or $102.2 million increase above the prior year's sales, is due principally to meat slaughtering and fabricating operations, and is attributable to full operating efficiency and better sales promotion.

Cost of sales increased by 15.9% or $309.4 million in the year ended July 29, 1978. The increase in the supermarket division, which reflects a 9.8% or $148.2 million increase above prior year's supermarket cost of sales, was caused primarily by a full year's effect of purchases in the acquired Penn Fruit and Hills stores ($146.9 million). Discount general merchandise cost of sales reflects a 25.4% or $59.8 million increase over prior year's which is due principally to an increase in merchandise purchases. The remaining increase of $101.4 million in cost of sales is attributable to increased costs associated with other operations of the Company, principally the meat slaughtering and fabricating operations.

Operating and administrative expenses increased 21.6% or $103.0 million for the year ended July 29, 1978. The supermarket division accounted for most of the increase and represents a 22.2% or $82.3 million increase over prior year's supermarket expenses due principally to increases in wages, occupancy, and supermarket and warehouse overhead expense. The discount general merchandise operations increase was caused principally by increased advertising costs and wages.

Interest expense increased by approximately $6,000,000 or 42.1% in 1978 principally as a result of an increase in the prime rate which is the basis for computing interest under many of the Company's loan agreements and the effect of the $50,000,000 revolving credit agreement being outstanding during all of 1978 and only partially in 1977. See Note 9 to the Consolidated Financial Statements for further data.

The increase in other income of approximately $5.9 million is the result of the 1978 increase in the gain on sales of real estate and equipment.

The increase in tax benefits of approximately $8.0 million is primarily due to the utilization of the net operating loss incurred in 1978. See Note 13 to the Consolidated Financial Statements for further data.

Income from operations decreased approximately $64,000,000 in 1978 to a loss of $48,000,000 due principally to heavy competitive pressures resulting in lower profit margins, particularly in the J.M. Fields operations, newly negotiated labor agreements substantially increasing payroll and fringe benefits, various accounting adjustments relating to the realizability of certain Company assets, a charge to operating and administrative expenses, representing the unreconciled excess of receivables over payables among the Company and consolidated subsidiaries at July 29, 1978, and the full year effect of operating and administrative expenses with respect to fiscal 1977 supermarket acquisitions. The adverse effect of these conditions may have been aggravated by serious deficiencies in the system of internal accounting controls.

1977 Compared to 1976

Sales decreased 2.8% or $70.3 million in the year ended July 30, 1977. The decrease in supermarket sales, which approximates 25% of the above, was due principally to the residual effects of a three-week strike in the Philadelphia area together with heavy competitive pressures in spite of 14 additional stores acquired in October 1976, and 43 Hills stores acquired May 1977. (Total stores in operation at the end of 1977 were 490 compared with 443 in 1976.) The decrease in discount department store sales which approximates 20% of the above, was caused primarily in the third and fourth quarters when a new management team, which assumed control in the second half of the fiscal year, made extensive changes in store layout, merchandising and store operations policies. In addition, three stores were closed as a result of prior unprofitability. The remaining decrease in sales were attributable to meat slaughtering and fabricating plant operations where a strike at the meat packing plant in Denver, Colorado halted operations for 14 weeks with full operating efficiency not being restored until year end.

Income from operations decreased approximately $3,000,000 or 16%, as a result of the aforementioned effects of the strike in the supermarket operations, the curtailment of promotional activity and implementation of new merchandising and operational procedures in the discount general merchandise operations.

The decrease in other income of approximately $4,000,000 or 76.3%, is a result of the 1977 decline in the gain on the sales of real estate and equipment.

Item 3. ***Properties***

The principal executive offices of the Company are located at 3175 John F. Kennedy Boulevard, Philadelphia, Pennsylvania 19101, which building is owned by a subsidiary.

As of July 29, 1978, the Company leased 312 of its supermarkets and 65 of the Fields department stores under agreements with third parties, which provided, in typical cases, for the construction of the retail facility by the landlord to the Company's specifications, and for the subsequent leasing thereof to the Company for periods of at least fifteen years (with renewal options) at negotiated rentals. Lease agreements provided in many cases for the payment by the Company of all or a portion of certain expenses, such as taxes and maintenance costs, and the payment of additional rentals based upon a percentage of sales from the premises.

The balance of the Company's supermarkets and its discount department stores were constructed by the Company (sometimes as part of a "strip" shopping center) and, except for the total of 113 supermarkets as to which the Company owned the fee interest, were occupied under net leases arising pursuant to sale-leaseback transactions. Substantially all of these leases give the Company renewal options and under certain circumstances, the right to reacquire these properties at various dates.

As a result of the termination since the end of the fiscal year of supermarket operations in New York, Connecticut, Philadelphia, Harrisburg and Tampa areas (see Item 1), and the subsequent assignment by the Company of its leasehold interests and sale of its fee interests at numerous locations, the Company presently operates 159 supermarkets under leases, 52 supermarkets in which it holds the fee interest, and 2 supermarkets under sale-leaseback arrangements.

As indicated in Item 1—"Competition" the Company is subject to intense competition at all of its supermarket locations. Many of the Company's supermarkets compete with supermarkets that are newer or have been more recently modernized than the Company's stores, a factor which operates to the disadvantage of the Company. The Company will seek to modernize its older stores and may from time to time close stores which cannot be economically modernized; however, there can be no assurance that the Company's financial condition will permit substantial expenditure for such modernizations.

All of the Company's meat facilities, its soft drink bottling plant and several of its auxiliary warehouses are owned in fee. The remainder of the Company's warehouse space and food processing facilities are occupied under long-term leases with renewal options, and in some instances, purchase options.

The Company deems its current warehousing facilities adequate for its needs, with sufficient capacity to meet its reasonably foreseeable requirements. Frozen food warehousing requirements are provided through independent suppliers. Machinery and equipment at its food processing facilities are deemed adequate for present and reasonably foreseeable requirements.

(See Note 15 to notes to consolidated financial statements.)

Item 4. ***Parents and Subsidiaries***

(a) *Parents*

As of April 6, 1979, Samuel Friedland was the direct beneficial owner of 1,011,947 shares (13.8%) of the Company's Common Stock. As to 114,965 (1.6%) of said shares, he held shared voting and dispositive power with his sons, Jack and Harold Friedland, and as to 800,000 shares (10.9%) owned by others, he was the sole voting trustee. Samuel Friedland may be deemed the indirect beneficial owner of an additional 247,063 shares of the Company's Common Stock (3.4%) held by Hasam Realty Corp. ("Hasam"). Hasam also holds the aforesaid 800,000 shares as pledgee. Samuel Friedland has advised the Company that, as of March 31, 1979, he (i) was the Chief Executive Officer of Hasam, and his sons, Jack and Harold Friedland, were officers of Hasam; (ii) owned directly 1.7% of Hasam's voting stock; (iii) held sole or shared voting and dispositive power as fiduciary as to an additional 28% of Hasam's voting stock; and (iv) held a vested remainder interest in a trust which held 49.6% of Hasam's voting stock, of which trust Harold and Jack Friedland are two of the three trustees and hold voting and dispositive power with respect to such shares. Harold and Jack Friedland have advised the Company that each also holds beneficially an additional .6% of Hasam's voting stock, and may also be deemed the indirect beneficial owners of Hasam's shares of Food Fair Common Stock.

Jack Friedland individually has sole voting and dispositive power as to 73,988 shares (1%) of Food Fair Common Stock and shares voting and dispositive power with Harold Friedland as to 3,000 additional shares of Food Fair Common Stock.

Based upon information presently available to the Company, it appears that the members of the Friedland family, including relatives by marriage, are direct or indirect beneficial owners, as of April 6, 1979, of more than 26% of the outstanding shares of the Company's Common Stock.

Any determination as to whether Samuel Friedland presently is a "parent" of the Company has been affected by the following: (i) the resignations on November 14, 1978 of Samuel and Jack Friedland and Louis Stein from all positions with Food Fair, (ii) the current status of Food Fair as a debtor-in-possession under Chapter XI and its consequent supervision by the Court and the Official Creditors' Committees, and (iii) the appointment of Grant C. Gentry, who is unaffiliated with Samuel Friedland, as Chairman of the Board, President and Chief Executive Officer of the Company, and the recent appointments of other unaffiliated senior executive officers and directors.

(b) *Subsidiaries*

Each of the corporations named below is a subsidiary of Food Fair. All such subsidiaries are consolidated with Food Fair for financial reporting purposes, except its wholly-owned life insurance company, Washington Square Life Insurance Company, and its wholly-owned finance company, Fields Credit Corp.

Parent	State of Incorporation
Food Fair, Inc.	Pennsylvania

Name of Subsidiary (Wholly-Owned)	
Newcorp Supermarkets, Inc.	Pennsylvania
Tulip Parking Corporation	Pennsylvania
J. M. Fields, Inc.	Florida
Fixtures and Equipment Leasing Co., Inc.	New Jersey
Ideal Shoe Company	Pennsylvania
Jersey Dell Milk Company, Inc.	New Jersey
Maryland Milk Company	Maryland
Sel-Lect Kent Corporation	Pennsylvania
Sharon Milk Products, Inc.	New York
Hernig Milk Company	Delaware
Sunshine Milk Company, Inc.	Florida
Mark Distribution Corporation	Florida
Washington Square Life Insurance Co.*	Pennsylvania
Fields Credit Corp.*	Nevada
Herco, Inc.	Delaware
Greys Poultry, Ltd.	Bahama Islands
Twin Packing Co. of Florida	Florida
Golden Banana, Inc.	Florida
El Dorado Sales, Inc.	Arizona
Idealco, Inc.	New York
Tulip Distributing Assn.	New Jersey
Supermarket Display Corp.	Delaware
B.I.P. Services, Inc.	Pennsylvania
Footwear Services, Inc.	New Jersey
Hills Supermarkets, Inc.	Delaware
Trojan Transportation, Inc.	Pennsylvania
F.F. Financial Corp.	Nevada
Food Fair Anne Arundel, Inc.	Maryland
Food Fair West Baltimore, Inc.	Maryland

* Financial statements not consolidated

Although the Company owns all of the outstanding common stock of Realmart, Inc., a Delaware corporation, Realmart has outstanding a class of preferred stock which is owned beneficially by two unaffiliated individuals. By its terms only the preferred stock may be voted in elections of Realmart's directors. Subject to Court approval, Realmart presently intends to redeem all the outstanding preferred stock. Realmart is consolidated in the Company's financial statements.

Monarch Investment Co., Ltd., an 80% owned subsidiary, incorporated in the Bahama Islands, is consolidated in the financial statements.

The names of certain other subsidiaries (including those in which the Registrant owns 50% of issued and outstanding common stock) have been omitted because, considered in the aggregate as a single subsidiary, they would not constitute a significant subsidiary.

Item 5. *Legal Proceedings*

The Company and nine of its subsidiaries are presently and have been since October 2, 1978, operating as debtors-in-possession under Chapter XI of the Bankruptcy Act, under the supervision of the Court. As a result of the filing by such corporations of petitions for arrangement under Chapter XI, or as the result of non-payment of various obligations, or both, the Company and various of its subsidiaries are or may be in default under numerous loan agreements, indentures, promissory notes, guarantees, leases of real and personal property, security agreements, mortgages, and other contractual arrangements, including arrangements with labor unions relating to health and welfare contributions, severance pay and pension contributions. The filing of the Chapter XI petitions gave rise to an automatic stay, under Bankruptcy Rule 11-44, of all actions against the filing entities, whether arising out of the foregoing matters or otherwise.

Many of the substantive allegations of the lawsuits described in (a) through (h) below are also the subject of investigations being conducted by Price Waterhouse & Co. on behalf of the Official Creditors' Committees, and by the Securities and Exchange Commission. (See Item 1.)

(a) The Company is a nominal defendant in an action, purportedly a shareholders' derivative action, filed on August 30, 1978, by one Harris Lewis, entitled *Harry Lewis* v. *Filigree Foods, Inc., et al* (United States District Court for the Eastern District of Pennsylvania). This lawsuit generally involves the Company and certain of its former officers, directors or agents or entities affiliated with or controlled by the latter. In general, the complaint alleges impropriety in dealings between the Company and Filigree Foods, Inc.; impropriety in dealings among the Company, J. M. Fields, Inc. and Richman Associates (a food brokerage firm of which Harold Friedland is the principal stockholder) and alleges damage to Food Fair as a result of its dealings with Filigree and Richman. The complaint further alleges that MGS Incentives Company, a former subsidiary of the Company, was sold by Food Fair to Harold Friedland in 1976 for a "grossly inadequate consideration" and that subsequent dealings between MGS and the Company were improper and caused further damage to Food Fair. The complaint concludes that "the acquisition of Filigree, Richman and MGS by the Friedland interests . . . improperly deprived Food Fair of advantageous corporate opportunities, properly belonging to the corporation . . . and unjustly enriched" certain defendants. (See Item 15(f).)

(b) The Company is a nominal defendant in an action, purportedly a shareholders' derivative action, filed on September 1, 1978, entitled *Alton E. Gross* v. *Harold Friedland, et al* (United States District Court for the Southern District of New York). The allegations in *Gross* are substantially the same as the allegations in *Lewis,* i.e. that the Company's dealings with Filigree Foods, Inc. and Richman Associates were disadvantageous to Food Fair. The *Gross* complaint also alleges that the purchase of Richman Associates by Harold Friedland constituted an improper diversion of a Food Fair corporate opportunity.

(c) The Company is a defendant in an action, purportedly brought as a class action on behalf of the holders of the Company's 4% Subordinated Debentures due April 1, 1979, filed on or about October 13, 1978, entitled *Eleanor Bader and Irving Bader* v. *Food Fair, Inc., et al* (United States District Court for the Southern District of New York). The complaint alleges a series of misleadingly optimistic shareholder communications during the period 1974 through October 3, 1978. The complaint states that the Company's annual reports and other communications failed to indicate numerous adverse developments concerning the Company's business, including the "strong emergence of competitors," the "numerous self-dealings and conflicts of interest of the Friedland Family," the Company's "declining position in the market place," its "continuing labor unrest," and its emerging liquidity problems and the understocked conditions of its supermarkets.

(d) The Company is the subject of an action, purportedly brought as a class action on behalf of the holders of common stock, filed on or about November 1, 1978, entitled *Mary M. Stein, Custodian* v. *Jack M. Friedland, et al* (United States District Court for the Eastern District of Pennsylvania). The allegations concerning false financial statements are similar to those contained in the *Bader* case. (See (c) above.) Among other matters, the plaintiff alleges the following material omissions from the Company's stockholder reports and financial statements: the existence of "massive backlogs in Food Fair's bookkeeping department;" serious problems in making payments to suppliers; inability to obtain credit from suppliers; and shortages at the stores and a consequent substantial reduction in sales and a declining cash flow. The plaintiff also cites a loss of confidence by suppliers in the Company because "Food Fair's brokers and wholesalers were close friends or relatives" of management. An allegation is also made that the Company's press releases accompanying the receipt of a $28 million loan in August, 1978, were misleading, in that such releases referred to the use of proceeds of such loan for "working capital" which plaintiff deems inconsistent with the fact that the proceeds were used for "payment of substantial creditors on delinquent or delayed accounts payable."

The *Stein* complaint also makes allegations concerning dealings between the Company, Filigree Foods, Inc. and Richman Associates and further alleges dealings with Vendor Distributors, Inc., a specialty food distributor run by Jay Lerner, brother of Marvin Lerner, then a vice president of the Company; Wiltshire Brokerage Co., a food broker run by Edward Bellet, son-in-law of Louis Stein, formerly Chairman of the Board of the Company; and Service Corp. of Florida, which allegedly is run by William B. Cohen, described as "a close personal friend" of Harold Friedland.

(e) The Company is a defendant in an action, purportedly brought as a class action, filed on November 19, 1978, entitled *William Elster* v. *Samuel Friedland, et al* (United States District Court for the Southern District of New York). This action is brought on behalf of a class consisting of "all persons who purchased securities of Food Fair, Inc. . . . during the period commencing October 5, 1975, and ending October 2, 1978." The plaintiff claims ownership of $20,000 of Food Fair's 4% Subordinated Debentures due April 1, 1979. The complaint alleges non-disclosure as to the following matters: self dealing by the Friedland and Stein families; the purchase by Food Fair of merchandise from sources controlled by the Friedland and Stein Families at prices higher than would have been paid to independent suppliers; inadequate bookkeeping; disadvantage to Food Fair in dealing in the food trade because of its reputation of dealing with insiders; and alleges non-disclosure of the fact that Food Fair's grocery stores were largely small stores operating in geographic areas where the population growth was static or declining and where the income levels were static or declining.

The damages alleged are those occurring by virtue of purchases of securities during the period October 5, 1975 through October 2, 1978.

(f) The Company is the subject of an action, purportedly brought as a class action on behalf of the holders of Food Fair common stock, filed on or about December 29, 1978, entitled *Steven Goldman* v. *Jack M. Friedland, et al* (United States District Court for the Eastern District of Pennsylvania). The period of damages alleged is limited to April 1, 1978 through October 2, 1978. The substantive allegations of the complaint are the same as in the *Stein* complaint referred to in (d) above.

Neither the Company nor any of the other named defendants has filed an answer in the actions described in paragraphs (a) through (f) above. All of such cases have been consolidated for pre-trial purposes in the Eastern District of Pennsylvania. In addition, a motion to dismiss is pending in the *Lewis* case on the grounds that proper demand has not been made upon the board of directors. A motion is also pending to require the plaintiffs in the *Lewis* case to post a bond for costs.

(g) An action entitled *Morris Ray* v. *Food Fair, Inc., et al* has been commenced by way of adversary proceeding in the Bankruptcy Court seeking to lift the automatic stay so as to permit commencement of a purported derivative action generally alleging damages to the Company arising out of alleged related party transactions. The Company has moved to dismiss this proceeding.

(h) On November 21, 1978, a stockholder of Amterre Development Inc ("Amterre") filed suit against Food Fair, Amterre, and Amterre's directors, in which it is alleged that Amterre was injured because of various sale and lease transactions with Food Fair. This suit, entitled *David Harrow* v. *Food Fair, Inc., et al,* is pending in the United States District Court for the Southern District of New York. It also alleges that Amterre breached its duty to the common stockholders of Amterre by failing to pay common stock dividends while periodically paying dividends on the 6% Preferred Stock owned by Food Fair. Finally, an injunction is sought as to the publicly announced proposed liquidation of Amterre on the grounds that such liquidation will be solely to the benefit of Food Fair, and that Amterre public stockholders will receive nothing in the liquidation. Amterre has informed the Company that on March 14, 1979, it filed a preliminary proxy statement with the Securities and Exchange Commission pertaining to a proposed liquidation of Amterre. The Company has also been advised that management of Amterre intends to proceed with the liquidation of Amterre subject to approval by Amterre's stockholders, in the absence of a contrary order of the Court. Management of Amterre, however, had advised the Company prior to institution of the *Harrow* suit that Amterre will not proceed with the liquidation unless a majority of the outstanding shares of Amterre Common Stock, other than shares held by the Company or beneficially owned by officers or directors of the Company or of Amterre, votes in favor of such liquidation.

* * *

Recovery by plaintiffs in the lawsuits described in (c) through (h) above could result in the imposition of liability upon the Company, subject to a possible right on the Company's part to recover against one or more of the other defendants or third parties. The possibility of such recovery or of any recoveries in the derivative suits referred to in (a) and (b) above or from other possible claims against former directors, officers or agents of the Company or others will depend in large part upon the results of investigations currently under way. (See Items 1 - "Investigation of Related Party Transactions" and 15(f) for information on such investigations). The Board of Directors will consider from time to time the results of such investigations and any other information that may become available to it to determine claims, if any, of the Company and appropriate action with respect thereto.

(i) On December 20, 1978, the New York Department of Taxation and Finance issued a "Notice of Determination and Demand For Payment of Sales and Use Taxes Due" (the "Food Fair Notice") to the Company for the period beginning with the quarter ended February 28, 1973 through and including the quarter ended August 31, 1977. The Food Fair Notice assesses a deficiency of $3,626,512 in New York sales and use tax for the period, plus interest in the amount of $1,692,919.

On December 28, 1978, the New York Department of Taxation and Finance issued a similar notice to J. M. Fields, Inc. ("Fields"), a wholly owned subsidiary of the Company, (the "Fields Notice") for the period beginning with the quarter ended February 28, 1973 through and including the quarter ended February 28, 1978. The Fields Notice assesses a deficiency of $874,006 in New York sales and use tax for this period, plus interest in the amount of $258,623.

At the present time it is not possible to estimate the Company's ultimate liability with respect to the alleged deficiencies.

(j) The Company, together with numerous other retail food companies and others, has been named as a defendant in multiple civil actions brought in various United States District Courts by certain cattle producers and feeders alleging violations of the antitrust laws in connection with the purchase and resale of beef. The cases, most of which have been or are anticipated to be consolidated for pretrial purposes in the United States District Court for the Northern District of Texas, seek damages in an unspecified amount and an injunction against further antitrust violations as alleged. Reference is made to Item 3 of the Company's reports on Form 8-K for January, 1976 and August, 1976, for a description of these cases. Management believes that no basis exists for the allegations made against the Company and, after consultation with counsel, is of the opinion that these actions will not have a material adverse effect on the financial condition of the Company. In October, 1977, the Company was advised that the United States District Court in Texas had determined to dismiss the cases consolidated before it upon the ground that under a recent decision of the United States Supreme Court the plaintiffs lacked standing to sue. The Court's decision does not directly apply to cases not consolidated before it. An appeal from the District Court's decision was argued before the 5th Circuit Court of Appeals on February 6, 1979, but no decision thereon has been rendered. Legislation recently introduced in Congress, if enacted, could have the effect of nullifying the favorable decision of the District Court even if such decision is affirmed on appeal.

(k) Reference is made to Item 3 of the report of the Company on Form 8-K for August, 1976, for a description of *First National Professional Insurance Corporation* v. *Beneficial National Life Insurance Company of New York, et al.* The Company has filed an answer denying the material allegations of the complaint, and to date only limited discovery has been taken. This action has been stayed as the result of the Chapter XI proceedings.

(l) Reference is made to Item 5 of the Company's reports on Form 10-K for the years ended July 31, 1976, and July 30, 1977, for a description of *Stonewall Insurance Company* v. *Food Fair Stores, Inc., et al.* As of July 29, 1978, the amount of the claims matured and unpaid by Stonewall aggregated approximately $8,445,000.

Although extensive discovery has been taken in the *Stonewall* case, substantial additional discovery remains to be taken. Counsel to the Company have advised that upon the basis of such discovery, plaintiff has not to date come forward with evidence sufficient to sustain its claim for recission. Nevertheless, in view of the substantial factual discovery remaining to be taken, the Company is not in a position to predict with certainty the outcome of this case.

(m) Reference is made to the Company's report on Form 10-Q for the period ending May 7, 1977, and Item 5 of its report on Form 10-K for the year ended July 30, 1977, for a description of *Auerbach* v. *Eberle.* There were no material developments in this case during the fiscal year ended July 29, 1978 and through May 31, 1979.

Item 6. *Increases and Decreases in Outstanding Securities and Indebtedness*

a. There was no increase or decrease during the period indicated in the amount of equity securities of the Company outstanding except as indicated below:

Preferred Stock

Outstanding at July 30, 1977	17,465 shares
Deduct: Shares redeemed for sinking fund purposes	1,200 shares
Outstanding at July 29, 1978	16,265 shares

In a series of transactions during the fiscal year ended July 29, 1978, the Company acquired by purchase in the open market 1,200 shares of the $4.20 Dividend Cumulative Preferred Stock. The Statement of Designation and Relative Rights and Preferences of the $4.20 Dividend Cumulative Preferred Stock, Series of 1951, $15 par value, requires the Company to set aside in a sinking fund, semi-annually, the sum of $120,000 less the sum of $100 for each share of such Preferred Stock which the Company may purchase or redeem and credit against such sinking fund requirements.

b. There were no increases or decreases in debt securities and indebtedness during the fiscal year ended July 29, 1978 previously reported in reports of the Company on Form 10-Q for periods within said fiscal year.

c. During the fourth quarter of the fiscal year ended July 29, 1978 the amount of debt securities or indebtedness outstanding did not increase by more than 5% of the affected class. (See Notes 8 and 20 of the notes to the consolidated financial statements with respect to a borrowing of $28,000,000 shortly after the close of said fiscal year.)

Item 7. *Changes in Security and Changes in Security for Registered Securities*

Under the loan agreement covering the $28,000,000 loan referred to in Item 6, the Company was prohibited from paying dividends on its Common Stock through January 31, 1979. The Company cannot pay dividends during the pendency of the Chapter XI Proceedings, and it may be anticipated that any plan of arrangement with unsecured creditors will prohibit or substantially limit the payment of dividends during any period (which could be lengthy) during which debt repayments to such creditors are required under the plan.

Item 8. *Defaults Upon Senior Securities*

The Company was in violation of certain restrictive covenants at July 29, 1978, and also as a result of the commencement of the Chapter XI proceedings is in default with respect to the following indebtedness:

Long-Term Portion:

Notes payable, banks	$50,432,000
Notes payable, other	4,000,000
Subordinated debentures, 8.5%	15,000,000
Sinking fund debentures, 8.38%	29,575,000
	$99,007,000

The Company is presently formulating a plan of arrangement which will provide for significant changes in the debt instruments and terms of payments.

Item 9. *Approximate Number of Equity Security Holders*

Set forth below is the approximate number of holders of record of each class of equity security of the Company outstanding at April 6, 1979.

Title of Class	Number of Record Holders
$4.20 Dividend Cumulative Preferred Stock, Series of 1951, $15 par value	52
Common Stock, $1.00	12,850
Common Stock Purchase Warrants expiring December 11, 1979	19

Item 10. *Submission of Matters to a Vote of Security Holders*

An annual meeting of shareholders was held on November 15, 1977. Proxies for said meeting were solicited pursuant to Regulation 14 under the Securities and Exchange Act of 1934. The Company issued its Proxy Statement dated October 31, 1977 in connection therewith.

Item 11. *Indemnification of Directors and Officers*

Section 1410 of the Pennsylvania Corporation Law (15 Purdon's Pennsylvania Statutes Annotated Sec. 1410) provides in general that a business corporation may indemnify its officers and directors, who are parties to litigation by reason of their position, against expenses (including attorneys' fees), judgments, fines and settlement amounts incurred in connection therewith if such persons acted in good faith. The statute also provides that a business corporation may indemnify its officers and directors for expenses (including attorneys' fees) incurred in defending or settling litigation brought against such persons by or in the right of the corporation if such person acted in good faith, except that no indemnification is permitted (with limited exceptions) where such persons have been adjudged liable for negligence or misconduct in the performance of their duties to the corporation. In any litigation of the nature discussed in the foregoing sentences, a corporation is required to indemnify an officer or director against expenses (including attorneys' fees) incurred by him if he is successful on the merits or otherwise in defense of such litigation. Indemnification payments to an officer or director authorized by the statute may be made only upon a determination made by: (i) the Board of Directors by a majority of disinterested directors, (ii) independent counsel or (iii) the shareholders, that indemnification is proper in the circumstances. Under certain circumstances, if approved in the manner set forth in the foregoing sentence, an officer or director may be advanced his expenses in defending an action if he undertakes to refund such advance unless it is ultimately determined that he is entitled to be indemnified. The provisions of this foregoing statute are not exclusive of other rights to which officers or directors seeking indemnification may be entitled under any by-law, agreement, vote of shareholders or disinterested directors.

On October 1, 1978, the Board of Directors adopted a resolution indemnifying officers and directors against expenses reasonably incurred in defending the case of *Lewis* v. *Filigree Foods, Inc. et al* (See Item 5, incorporated herein by reference, for a description of such litigation.) and a further resolution providing that such expenses, and expenses incurred in the defense of other litigation arising out of matters which are similar to the matters and causes alleged in such case, be paid to such officers and directors in advance, provided that the recipients of such advances execute undertakings to refund such advances unless it is ultimately determined that they are entitled to such advances. The effect of the Chapter XI proceedings on the Company's obligations, if any, under this resolution, is unclear, as is the validity of the resolution itself, given the circumstances of its adoption.

On March 13, 1979, the Court approved the adoption by the Board of Directors on February 23, 1979, of a new By-Law provision, which generally accords to officers and directors the rights to indemnification which are authorized by the above described Section 1410 of the Pennsylvania Corporation Law. The By-Law does not authorize, however, indemnification with respect to matters relating to financial participation by officers or directors or members of their families in transactions involving conflicts of interest, usurpation of corporate opportunities or other breaches of fiduciary responsibilities to the Company. The new By-Law provision is annexed as an Exhibit to this report. (See Item 12.) The Order of the Court provides that such resolution is effective as of October 2, 1978, provided, however, that it applies only to officers and directors as of March 13, 1979 or thereafter. This By-Law may supersede the aforesaid Board resolution of October 1, 1978.

To date, no indemnification payments or advances have been made by the Company to or on behalf of any present or former director or officer and no indemnification will be made without the approval of the disinterested members of the Board of Directors.

Item 12. *Financial Statements, Exhibits Filed, and Reports on Form 8-K*

(a) 1. *Financial Statements*

See Index to the annexed financial statements.

2. *Exhibits*

A. Loan Agreement with First Pennsylvania Bank and other lenders dated as of July 28, 1978.

B. Security Agreement with First Pennsylvania Bank and other lenders dated as of July 28, 1978.

C. Pledge Agreement with First Pennsylvania Bank and other lenders dated as of July 28, 1978.

D. Letter of Touche Ross & Co., dated April 25, 1979.

E. Indemnification By-Law, adopted February 23, 1979.

(b) No reports on Form 8-K were filed during the last quarter of the fiscal year ended July 29, 1978.

Item 13. *Security Ownership of Certain Beneficial Owners and Management*

The following table sets forth, as of March 31, 1979, information concerning the beneficial ownership of the Company's common stock by (1) each director; (2) all directors and officers as a group (14 persons); and (3) each person who is known to the Company to be the beneficial owner of more than five percent of the Company's common stock:

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership: Sole Voting and Investment Power	Shared Voting and Investment Power	Total Beneficial Ownership	Percent of Class
(a) *Directors*				
Robert Anderson	–0–	–0–	–0–	—
George Friedland	292,208	19,028(1)	311,236	4.2%
Roger L. Galassini	–0–	–0–	–0– (3)	—
Grant C. Gentry	–0–	–0–	–0– (2)	—
John T. Grigsby, Jr.	–0–	–0–	–0– (3)	—
Frank N. James	1,311	–0–	1,311(3)	*
Gerald Nathanson	–0–	–0–	–0– (4)	—
James J. Needham	1,000	–0–	1,000	*
Joseph L. Castle	–0–	–0–	–0–	—
(b) All Officers and Directors as a Group	294,878	19,028	313,906	4.3%
(c) Beneficial Owners of Over 5% of Class				
Hasam Realty Corp. . . . . 8080 N.E. 5th Ave. Miami, Florida 33138	247,063(5)	800,000(5)	1,047,063(5)	14.2%
Samuel Friedland . . . . Hollywood-By-The Sea, Hollywood, Florida	896,982(5)	362,028(5)	1,259,010(5)	17.1%
Jack Friedland . . . . 1020 North Lane Gladwyne, Pa. 19035	73,988(5)	1,165,028(5)	1,239,016(5)	16.8%
Harold Friedland . . . . 2 Bala Cynwyd Plaza Bala Cynwyd, Pa.	–0– (5)	1,047,063(4)	1,047,063(5)	14.2%

* Less than .01%

(1) Held by the George Friedland Foundation, of which George Friedland is a Trustee.

(2) Mr. Gentry was granted options to purchase 200,000 shares at $2.00 per share in connection with his employment; such shares would, upon exercise, constitute 2.7% of the outstanding common stock. (See Item 15(b)(i)(B) incorporated herein by reference.)

(3) On April 11, 1979, Messrs. James, Galassini and Grigsby were granted, subject to Court approval (which was issued on May 2, 1979), options to purchase 15,000, 10,000 and 10,000 shares, respectively, at $4.44 per share. (See Item 15(d)(3).)

(4) Mr. Nathanson has agreed to purchase and the Company has agreed to sell 200,000 shares on terms described in Item 15(d)(1) hereof, incorporated herein by reference. Such shares would, upon purchase, constitute 2.7% of the outstanding common stock.

(5) The Company has been informed that Hasam Realty Corp. ("Hasam"), Samuel Friedland, Jack Friedland and Harold Friedland beneficially own an aggregate of 1,335,998 shares or 18.2% of the total outstanding. Hasam is the direct owner of 247,063 shares and the pledgee of 800,000 shares which were sold in April, 1979, to four shareholders of Hasam, of which Jack and Harold Friedland each purchased 200,000 shares. The beneficial ownership indicated for Jack and Harold Friedland include shares owned and held in pledge by Hasam. The 800,000 pledged shares are held in a voting trust of which Samuel Friedland is sole voting trustee. The beneficial ownership indicated for Samuel Friedland includes the aforesaid 247,063 (3.4%) shares held by Hasam, 800,000 shares (10.9%) held by him as voting trustee, and 114,965 shares (1.6%) held by Samuel Friedland Family Foundation. (See Item 4.)

Item 14. ***Directors and Executive Officers of the Registrant***

Set forth below is certain information concerning each director and executive officer of the Company:

GRANT C. GENTRY—Chairman of the Board, President and Chief Executive Officer
Age—55

Mr. Gentry was appointed to his present position as Chairman of the Board, President, and Chief Executive Officer on January 4, 1979. From April 1, 1978 to January 4, 1979 he was a Partner and Management Consultant with Adamy, Foley & Gentry, Chicago, IL. From March 1, 1975 to November 11, 1977 he was President and Director of the Great Atlantic and Pacific Tea Company, Chicago, IL. From March 1, 1958 to March 1, 1975 he served in various positions at Jewel Companies, Inc., Chicago, IL, ultimately becoming Executive Vice President and Director. Mr. Gentry also serves as a director of Olson Farms, Inc. and Borman's, Inc.

FRANK N. JAMES—Vice President, Chief Operating Officer and Director; President of Supermarket Division
Age—54

Mr. James was appointed to his present position as Vice President and Chief Operating Officer of the Company and President of the Supermarket Division in March 1979. He has served as a Director of the Company since January, 1977. From June, 1978 to March, 1979 he was Vice President in charge of Administrative Services. He was President of the Company's Pantry Pride Supermarket Division from September, 1976 to June, 1978, becoming a corporate Vice President in September, 1976. From January, 1975 to May, 1976 he was President of Colonial Stores, Inc. a supermarket chain based in Atlanta, Georgia. Mr. James previously served as a Director of the Company from August, 1973 to January, 1975, and during such time he was a Vice President.

ROBERT B. ANDERSON—Director
Age—68

Mr. Anderson was appointed a Director on April 11, 1979. He is President of Robert B. Anderson & Company, Ltd., his principal occupation being an attorney and business consultant. He also serves as a member of the Boards of Directors of: C.I.T. Financial Corporation, The Fed-Mart Corporation, The Goodyear Tire and Rubber Company, Intercontinental Trailsea Corporation, and Pan American World Airways, Inc.

JOSEPH L. CASTLE—Director
Age—46

Mr. Castle was appointed a Director on May 15, 1979. He is the Principal of Joseph L. Castle Associates, a firm engaged in business financial consulting. He also serves as Trustee for Reading Company.

GEORGE FRIEDLAND—Director

Age—77

Mr. Friedland has been a Director since 1937, and has been a private investor during the past five years. He also serves as a member of the Board of Directors of Amterre Development Inc.

JAMES J. NEEDHAM—Director

Age—52

Mr. Needham was appointed a Director March 20, 1979. He was a Distinguished Professor, Graduate Division of the College of Business Administration of St. John's University from 1977 to 1978. From 1972 to 1976, he served as Chairman and Chief Executive Officer of the New York Stock Exchange, Inc. Mr. Needham is also a member of the Boards of Directors of: Merrill Lynch Municipal Bond Fund, Inc., Merrill Lynch CMA Money Trust, Lexington Growth Fund, Inc., Lexington Research Fund, Inc., Lexington Income Fund, Inc., Lexington Tax Free Income Fund, Inc., The Lexington Money Market Trust, SCA Services, Inc., NVF Company, Sharon Steel Corporation, Caesars World, Inc., and Caesars New Jersey, Inc.

GERALD NATHANSON—Vice President and Director; President of J. M. Fields, Inc.

Age—42

Prior to joining the Company in January, 1977 in his present positions, Mr. Nathanson was the President of Jefferson Stores, Inc., a department store chain based in Miami, Florida, from February, 1975 to December, 1976, and was Senior Vice-President of Jefferson Stores, Inc. from October, 1971 to January, 1975.

JOHN T. GRIGSBY, JR.—Vice President, Chief Financial Officer and Director

Age—39

Mr. Grigsby was appointed to his present position as Vice President, Chief Financial Officer, and Director on April 11, 1979. From 1969 to April 10, 1979 he was a Certified Management Consultant with Touche Ross & Co.

ROGER L. GALASSINI—Vice President—Administration, General Counsel and Director

Age—40

Mr. Galassini was appointed to his present position in February, 1979. He was employed by The Great Atlantic and Pacific Tea Company from July, 1975 to February, 1979, as Vice President for Public Affairs, becoming Vice President for Administrative Services in April, 1978. From March, 1969 to July, 1975 he was employed by Jewel Companies, Inc., as corporate counsel, becoming assistant General Counsel in December, 1972 and Secretary in October, 1974.

WILLIAM H. McCHESNEY—Vice President—Accounting

Age—55

Mr. McChesney was appointed to his present position in March, 1979. From August, 1973 to October, 1977 he was Vice President and Controller of Colonial Stores, Inc., and from December, 1977 to March, 1979 was employed by Vornado, Incorporated, a chain of general merchandise stores, as assistant Vice President—Finance until June, 1978 and thereafter as Controller.

DARRELL V. STIFFLER, JR.—Vice President—Industrial Relations

Age—53

Mr. Stiffler was appointed to his present position in September, 1978. From 1973 to August, 1978 he was Vice President of Industrial Relations for the Great Atlantic and Pacific Tea Company, Inc.

NEIL THALL—Vice President and Director, Management Information Services

Age—32

Mr. Thall was appointed to his present position in April, 1979. From 1973 to April, 1979 he was a management consultant with Touche Ross & Co.

HOWARD F. GORDON—Secretary
Age—38

Mr. Gordon was appointed Secretary in 1975; he has also been Corporate Counsel since 1972, and was named Assistant General Counsel in March, 1979.

LEO DICANDILO—Treasurer
Age—58

Mr. Dicandilo was appointed to his present position as Treasurer January 8, 1974. From August 16, 1966 to January 7, 1974 he was Assistant Secretary of the Company.

Item 15. *Management Remuneration and Transactions*

(a) The table below sets forth information as to aggregate remuneration paid on an accrual basis by the Company during the fiscal year ended July 29, 1978 to each of its five most highly compensated executive officers or directors as to whom total remuneration exceeded $50,000, and as to all directors and officers as a group.

Name of individual or persons in group	Capacities in which served	Salaries, fees, commissions, and bonuses
Jack M. Friedland	President and Director (resigned in November, 1978)	$ 175,000
Gerald Nathanson	Vice President; President, J. M. Fields, Inc.	$ 200,000
Frank N. James	Vice President; President, Pantry Pride Supermarket Division	$ 100,000
Marvin N. Lerner	Executive Vice President of Pantry Pride Supermarket Division (resigned in March, 1979)	$ 93,333
S. Robert Silverman	Vice President, Director of Distribution (resigned in December, 1978)	$ 82,333
All directors and officers as a group (18 persons)		$1,024,225

The remuneration set forth above excludes any value attributable to incidental personal benefits, including use of Company automobiles, which may be derived by certain officers and directors. Management is not presently aware of any instance where the aggregate amount of such personal benefits exceeded $10,000 for any officer or director; however, such benefits are one of the areas currently being examined by Price Waterhouse & Co. in connection with its investigation. (See Item 1—"Investigation of Related Party Transactions.")

(b) *Proposed Remuneration*

(i) *Employment Agreements*

(A) Gerald Nathanson is employed pursuant to a contract, the term of which commenced in January, 1977 and which expires at the end of the Corporation's 1982 fiscal year. Under the contract, he receives an annual salary at the rate of $200,000, and a bonus of (i) $25,000 in any fiscal year in which the pre-tax profits (as defined) of the J. M. Fields Department Store Division are at least $7.5 million, and (ii) one percent (1%) of the amount by which such profits exceed $7.5 million, up to a maximum annual compensation of $450,000. Mr. Nathanson is also entitled to various fringe benefits, including payment by the Company of the premium on a $1 million life insurance policy which is in addition to the insurance normally carried by the Company for its key employees, and to disability payments in the event of permanent disability while employed, such payments being equal to 50% of base salary after six months and to 25% thereof after expiration of the five-year employment contract and continuing until age 65.

As a result of the closing and present ongoing liquidation of the J. M. Fields general merchandise discount department store operations, it is anticipated that Mr. Nathanson's employment with the Company will terminate. The Company has determined to seek an order from the Court to reject and disaffirm its contract with Mr. Nathanson.

(B) On January 4, 1979, the Company entered into an employment agreement ("Agreement") with Grant C. Gentry, pursuant to which Mr. Gentry is serving as President, Chairman of the Board and Chief Executive Officer of the Company.

Pursuant to the Agreement, Mr. Gentry will be paid basic compensation consisting of a salary of $350,000 per year for the five-year term of the Agreement. Mr. Gentry was also paid the sum of $100,000 upon execution of the Agreement. In the event of Mr. Gentry's death or disability while employed, payment of such base compensation will continue to be made to his present wife and, under certain circumstances, may be accelerated. The Company is also obligated to pay to Mr. Gentry, beginning on the later of (i) January 2, 1984 or (ii) his retirement from full time employment with the Company, for the remainder of his life and, if his present wife survives him, thereafter to her for the remainder of her life, as deferred compensation, the annual sum of $54,881, provided that Mr. Gentry has not, on or before January 2, 1984, either been discharged for cause, as specified in the Agreement, or voluntarily resigned his employment with the Company. Under certain circumstances, payments of deferred compensation to Mr. Gentry's wife may be accelerated.

The Agreement further provides for the issuance to Mr. Gentry of non-transferable options to purchase from the Company, on or before January 2, 1984, an aggregate of 200,000 shares of the Company's common stock at a cash price of $2.00 per share. Mr. Gentry may require the Company to register the shares acquired pursuant to such option, and may include such shares in any registration statement otherwise filed by the Company.

Mr. Gentry is also entitled to participate in employee fringe benefits generally available to the Company's key employees.

In order to assure Mr. Gentry of the availability of funds to comply with the Company's obligations, the Company has established separate trust funds with respect to and to secure the Company's obligations to pay base and deferred compensation to Mr. Gentry. Under the trust agreement pertaining to Mr. Gentry's base compensation, the Company deposited $1,558,662 in trust; under the trust agreement relating to Mr. Gentry's deferred compensation, the Company deposited $589,725 in trust. The trust agreements provide that the sums held in trust shall be reduced (and the amount of such reductions returned to the Company) in amounts equal to payments made by the Company to Mr. Gentry pursuant to the Agreement.

In the event of termination of Mr. Gentry's employment as a result of the transfer of the Chapter XI Proceedings to Chapter X of the Bankruptcy Act, or the liquidation of the Company or its adjudication in bankruptcy, Mr. Gentry is entitled to receive the present value of the remaining unpaid balance of his base compensation and the principal of the trust securing his deferred compensation.

(C) Frank James is entitled to deferred compensation equal to $15,000 times the number of years he is employed by the Company since January 1, 1977, payable in installments upon his retirement, or to his designee in the event of his death prior to retirement. The Company has also undertaken to pay Mr. James, upon his retirement at normal retirement age, the amount of $11,390 per annum during his lifetime, which amount is equivalent to the pension that Mr. James would have received under the Company's Salaried Employees Retirement Plan (but for his voluntary separation from service in January, 1975) upon retirement by reason of his service with the Company prior to January, 1975.

(ii) *Salaried Employees Retirement Plan*

The Salaried Employees Retirement Plan (the "Retirement Plan") provides fixed retirement benefits for regular employees of the corporation. Based upon certain assumptions, including the continuation of the Retirement Plan without amendment, the following table shows the annual retirement benefits which would be payable to persons at various salary levels after specific years of service:

Basic Annual Pay Assumed Constant	Estimated Annual Retirement Benefits for Number of Years Future Credited Service		
	10 years	20 years	30 years
$ 50,000	$ 6,175	$12,345	$18,520
100,000	13,675	27,345	41,020
150,000	21,175	42,345	63,520
200,000	28,675	57,345	75,000*
250,000	36,175	72,345	75,000*
300,000	43,675	75,000*	75,000*
350,000	51,175	75,000*	75,000*
400,000	58,675	75,000*	75,000*

* Maximum benefit provided by the Retirement Plan.

The above figures are based upon the Retirement Plan, as amended, assuming the 1978 Social Security level remains constant. Contributions are made solely by the Company and are determined on a group basis.

(c) *Remuneration of Directors*

(1) During the fiscal year ended July 29, 1978, directors who were not otherwise employees of the Company, or recipients of the consulting fees described in (2) below, received an annual fee of $7,200 plus $200 for each Board committee meeting attended. On April 11, 1979, subject to Bankruptcy Court approval, director remuneration was revised to provide that in the future, non-employee directors would receive annual fees of $10,000 plus $500 for each Board meeting attended and $500 for each Board committee meeting attended when the Board as a whole did not meet on the same day.

(2) Until November, 1978 and March, 1979, respectively, Louis Stein and Herman Silver were parties to consulting arrangements with the Company whereby they received consulting fees in lieu of any director's fees or other compensation to which they may have been entitled. For financial consulting as well as his services as a director, Mr. Stein was compensated at an annual rate of $40,000. Mr. Silver was compensated at an annual rate of $30,000 for consulting services rendered by him regarding the Company's meat operations as well as for serving as a director of the Company.

(3) In March, 1979, James J. Needham entered into a consulting services agreement with the Company providing for payments to him of an additional $17,000 per annum. This agreement was approved by the Bankruptcy Court on March 23, 1979.

(d) *Options, Warrants or Rights*

(1) In connection with his employment pursuant to an employment agreement, Mr. Nathanson has entered into agreements with the Company providing for the sale by the Company to, and purchase by, him of an aggregate of 200,000 shares of the Company's Common Stock. Mr. Nathanson is obligated to purchase 100,000 shares at a price of $5.625 per share, (payment to be made on or before August 1, 1982) and to purchase an additional 100,000 shares on or before August 2, 1987, at a price of $6.00 per share, provided that no more than 10,000 of such latter shares may be purchased in any 12-month period. In the event of termination of Mr. Nathanson's employment for cause or voluntarily by him prior to payment for all of such shares, or if Mr. Nathanson's employment is not renewed beyond the term of his existing employment agreement, the Company has the option to terminate Mr. Nathanson's right to purchase shares for which payment has not been made; in the event his employment is terminated otherwise than as aforesaid, Mr. Nathanson has the option to terminate his obligation to purchase such shares.

(2) Mr. Gentry holds options to purchase 200,000 shares of the Company's Common Stock at $2.00 per share. (See Item 15(b) (i) (B) above.)

(3) On April 11, 1979, the Board of Directors adopted, subject to the approval of the Bankruptcy Court (which approval was obtained by order dated May 2, 1979), a non-qualified employee stock option plan (the "Option Plan"). Pursuant to the terms of the Option Plan, 150,000 shares of the Company's common stock have been reserved for issuance thereunder. Also, on April 11, 1979, certain of the Company's officers and other key employees were granted nontransferable options under the Option Plan to purchase specified quantities of common stock (100,000 shares in total) at a purchase price per share equal to the mean of the closing bid and asked prices thereof on the date of grant, i.e. $4.44. On May 15, 1979, the Board of Directors granted, subject to Bankruptcy Court approval, to an officer an option to purchase 5,000 shares at a price per share of $3.50. Therefore, an aggregate of 105,000 shares of common stock are covered by the options granted to date, of which options covering 55,000 shares were granted to officers as a group including 15,000 shares to Frank N. James. The Plan provides that no option thereunder may be exercised prior to six months after the date of grant thereof.

(e) *Indebtedness of Management.*
None.

(f) *Transactions with Management*

As indicated in Item 1 under "Investigation of Related Party Transactions", for some months there have been under way investigations, currently conducted by Price Waterhouse & Co., independent public accountants, (who have retained Pepper, Hamilton & Sheetz, Philadelphia, as legal counsel in such investigations) under the direction of the Official Creditors' Committees, with respect to transactions between the Company and persons or entities affiliated with the Company's management in the fiscal year covered by this report (most of whom have resigned since the institution of the Chapter XI proceedings). Based upon its understanding that Price Waterhouse & Co. is addressing and investigating all related party transactions (and in view of the substantial expense being borne by the Company for such investigation), the Company's present management determined that a duplicative investigation would involve unnecessary time, effort and expense, and has elected to rely upon the report of Price Waterhouse & Co. which is to be submitted with respect to related party transactions. Accordingly, neither the Company's present management nor its counsel have instituted a separate investigation with respect to related party transactions; nor have they independently verified all the information hereinafter set forth (but the Company has no current information indicating the following is inaccurate in any material respect). If the report of Price Waterhouse & Co. should disclose additional material information on related party transactions, an appropriate supplemental report will be filed by the Company pursuant to the Securities Exchange Act of 1934.

In addition to the Price Waterhouse & Co. investigation, a number of the transactions described below are the subject of lawsuits and an investigation by the Securities and Exchange Commission.

(i) During the fiscal year, one of the food brokerage firms through which the Company purchased food products was Richman Associates ("Richman"), a concern of which, the Company is advised, the principal partner is Harold Friedland, a brother of Jack Friedland, son of Samuel Friedland and nephew of Louis Stein. Harold Friedland had been a vice-president and director of the Company until his resignation in November, 1976. In December 1977, Harold Friedland was elected as a director and officer of Hasam Realty Corp. which may have been a parent of the Company at such time. See Item 4. Richman earned brokerage fees on Company purchases with respect to which Richman acted as broker. Although the Company does not keep records which enable it to compute the volume of merchandise purchased through a particular broker, it does believe that the amount of brokerage fees earned by Richman on Company-related business during the fiscal year was substantial.

(ii) During the fiscal year the Company paid $3,400,000 for promotional and premium merchandise supplied by MGS Incentives, Inc. ("MGS"), a corporation of which Harold Friedland is a principal shareholder and officer. Harold Friedland purchased all of the stock of MGS from the Company for $20,000 in December, 1976. MGS had administered certain of the Company's supermarket promotional campaigns while a Company subsidiary, although at the time of its sale the Company was not conducting significant promotional activity involving MGS.

(iii) The Company has leased from Diplomat Mall Shopping Center, Inc., a subsidiary of Hasam Realty Corp. (see Item 4) a food supermarket and J. M. Fields Department Store aggregating 103,900 square feet, in a shopping center located in Hallandale, Florida. The lease, which commenced September 17, 1970, provides for a twenty-year term, with five 5-year renewal options, at a minimum annual rental of $275,880. The lease also provides for a percentage rental of 1% of gross supermarket sales and 2% of gross department store sales, less the minimum net rental and taxes on the premises.

(iv) The Company sells food and non food items from its Miami warehouse to the Diplomat Hotel which is wholly owned by Hasam Realty Corp. (see Item 4). Prior to December 1, 1978, many of these items were sold at the Company's warehouse cost, i.e. the original cost of the items to the Company; since December 1, 1978, the Company has included an additional 6% charge to its prices to cover freight, handling and a profit factor. During fiscal 1978 sales to the Diplomat Hotel totalled $80,000.

(v) Carlton Industries, Inc. ("Carlton"), a corporation which was controlled by Samuel P. Mandell during the time that he was a Company director (and now controlled by Seymour Mandell, Samuel Mandell's son), leases a public cafeteria and newsstand on the main floor at the Food Fair Building, Philadelphia, for a term expiring June 30, 1983, at an annual rental of $35,000 plus 4% of gross sales of the newsstand. Carlton also services the Company's employees cafeteria in Philadelphia and serviced the employees in its Linden, New Jersey warehouse, until it was closed, supplying food, service and management on the basis of cost plus 10% of sales. During the fiscal year ended July 29, 1978, the Company paid Carlton approximately $147,000 for food and food services so supplied. These arrangements are terminable by either party at will, and all purchases are on competitive terms.

(vi) During 1976, in connection with the arrangement proceedings under Chapter XI of Filigree Foods, Inc. ("Filigree"), a wholesale grocery company which had previously serviced the Company's supermarkets in the northern New Jersey area, Hasam Realty Corp. ("Hasam"; See Item 4) acquired 570,331 shares of common stock of Filigree, equal to a 49% interest, for an investment of $500,000, and warrants to acquire an additional 116,394 shares of Filigree common stock, equal to a 10% interest. Hasam granted to the Company an option, originally exercisable until April, 1977, and extended until April, 1979, which has not been exercised, to acquire Hasam's interest in Filigree for an amount equal to Hasam's investment plus carrying costs. Filigree's lenders required Filigree to obtain the Company's agreement that in the event of future default by Filigree on its loans, the Company would bid at any foreclosure sale of Filigree's grocery inventory an amount equal to 50% of the wholesale cost thereof, up to a maximum of $4,000,000. Hasam agreed to indemnify the Company for any loss that might be sustained by the Company in event it were to purchase such merchandise, and additionally transferred to the Company in consideration of such undertaking warrants to acquire 58,197 shares of Filigree common stock. Hasam also agreed that should the Company exercise its option to acquire Hasam's interest in Filigree, Hasam would also transfer to the Company, without additional consideration, Hasam's remaining stock purchase warrants.

Filigree serviced the Company's Hills, Pantry Pride, and Penn Fruit supermarkets. During the fiscal year ended July 29, 1978, Filigree sold $123,400,000 in groceries to the Company and purchased approximately $4,785,000 of products from various of the Company's manufacturing, processing and produce operations.

In early 1978, Filigree agreed to expand its capacity in order to service the perishable produce requirements of the Company's northern New Jersey supermarkets. Contemporaneously, the Company closed down its perishable produce facilities at its Linden, New Jersey warehouse in connection with a planned total termination of operations at such warehouse.

The Company assisted Filigree in securing appropriate warehouse facilities and related equipment for handling perishable produce, by entering into two leases, which became effective in mid 1978, therefor and in turn subleasing the same to Filigree. The leases were to run for 20 years and called for aggregate rentals over the terms thereof of approximately $4,385,000. The arrangement between the Company and Filigree contemplated that Filigree's payments under the subleases would cover all of the Company's rental and other direct obligations under the leases. Filigree rejected and disaffirmed the subleases as of December 7, 1978 in connection with its own Chapter XI bankruptcy proceedings, and the Company did likewise with respect to the leases on January 3, 1979.

In order to obtain a license from the United States Agriculture Department to purchase perishable produce, Filigree was required to post a $600,000 bond, which it was able to obtain from an insurance company only after: (a) Hasam posted a $500,000 letter of credit with the issuer of the bond and (b) World Wide Produce Co., a division of the Company in the produce business which sold produce to Filigree, agreed with the insurer to waive coverage under the bond.

The Company is advised that Filigree filed a petition under Chapter XI in the Bankruptcy Court in the District of New Jersey. On December 19, 1978, the Court appointed receiver of Filigree filed a complaint at the Bankruptcy Court for the Southern District of New York seeking recovery with respect to $7,198,000 in merchandise sold and delivered by Filigree to the Company prior to the filing of the Company's petition in Bankruptcy on October 2, 1978. The Company is presently reviewing its records as well as documents supplied it by Filigree and based upon this review, it is now believed that as of October 2, 1978, the Company received invoices payable to Filigree in the approximate amount of $7,100,000. A further review of the Company's records reflected that the Company and its wholly owned subsidiaries have the amount of approximately $2,200,000 due them from Filigree for goods and services. The Company intends to assert this claim in the presently pending proceedings before the Bankruptcy Court for the Southern District of New York.

The receiver of Filigree has also filed a complaint in the Court seeking recovery in the amount of approximately $101,000 for goods sold and delivered to Food Fair during the period October 2, 1978 through November 8, 1978. The Company is currently investigating this complaint. Based upon a preliminary review of the records of the Company, it now appears that the Filigree complaint sets forth approximately the correct amount of the invoices for goods sold and delivered by Filigree to the Company. However, the Company's records also reflect accounts receivable due it from Filigree in the approximate amount of $156,000 for the period after October 2, 1978.

(vii) Royal Palm Beach Colony, Inc. ("Royal"), a public corporation of which Samuel Friedland may be deemed the "parent", leases its executive office facility in Miami, Florida comprising 37,000 square feet, from the Company, under a 10-year lease providing an annual net rental of $47,500. During 1976, Royal made arrangements to lease new office space elsewhere, with the Company to re-occupy its former space. However, these arrangements were terminated at the request of the Company upon its agreement to assume Royal's obligations with respect to the new space which Royal had leased. During 1978, the Company paid approximately $80,000 in rentals pursuant to such assumption.

(viii) In March 1978, Hasam Realty Corp. (See Item 4) purchased, at par, an $800,000 participation in a purchase money note bearing interest at 8.5% per annum; which note is secured by a mortgage and owed by an unrelated third party to an affiliate of the Company as a result of an earlier sale of certain real estate by such affiliate. Hasam Realty Corp. subsequently increased its participation to $1,200,000. The face amount of the entire note was $3,300,000. On or about August 11, 1978, the entire note was paid in full. Hasam Realty Corp. earned approximately $27,000 in interest on its aforesaid participation.

(ix) The Company leases a small retail store in Florida from an affiliate of Hasam, on a year to year basis. The present basic rental is at the rate of $7,800 per year; during the fiscal year ended July 29, 1978, Food Fair paid an aggregate of approximately $8,000 to such affiliate, representing basic rent, taxes and other charges.

(x) During fiscal year 1978 the Company purchased approximately $680,000 of gourmet food items from Vendors Distributors, Inc., a wholesale food distributor. The President of Vendors was Jay Lerner, brother of Marvin Lerner who had served as a director and officer of the Company until his resignation in March, 1979. Vendors filed in bankruptcy shortly after the Company's Chapter XI proceedings had commenced.

(g) *Transactions With Pension or Similar Plans*
None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: June 15, 1979

FOOD FAIR, INC.

By JOHN T. GRIGSBY, JR.
John T. Grigsby, Jr., Vice President
and Chief Financial Officer

By WILLIAM H. MCCHESNEY
William H. McChesney, Vice President
and Chief Accounting Officer

FOOD FAIR, INC. AND SUBSIDIARIES

ITEM 12(a) FINANCIAL STATEMENTS AND SCHEDULES

FIFTY-TWO WEEKS ENDED JULY 29, 1978 AND JULY 30, 1977

The individual financial statements of the Registrant have been omitted because the Registrant is primarily an operating company and all subsidiaries included in the consolidated financial statements, in the aggregate, do not have minority equity interests and/or indebtedness to any person other than the Registrant or its consolidated subsidiaries in amounts which together exceed 5 percent of consolidated total assets at July 29, 1978, excluding indebtedness incurred in the ordinary course of business which is not overdue and which matures within one year from the date of its creation and indebtedness of subsidiaries collateralized by the Registrant.

Schedules other than those listed above have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

ACCOUNTANTS' REPORT

Board of Directors and Shareholders
Food Fair, Inc. (Debtor-in-Possession)
Philadelphia, Pennsylvania

We have examined the consolidated balance sheets of Food Fair, Inc. and Subsidiaries at July 29, 1978 and July 30, 1977 and the related consolidated statements of operations, retained earnings and changes in financial position and the supporting schedules listed on the preceding contents page for the fifty-two week periods then ended. Except as indicated in the following paragraphs, our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

RESTRICTIONS IN SCOPE OF EXAMINATION FOR 1978

Inadequate accounting controls and records

The system of internal accounting controls of the Company's discount department store subsidiary developed serious deficiencies during the year ended July 29, 1978. These systems (which include internal reporting systems and maintenance of accounting records) were inadequate for the purpose of properly recording sales and purchases and maintaining reliable records of accounts payable and inventories. These transactions and amounts enter materially into the determination of financial position, results of operations and changes in financial position. The inadequacies in the system of internal accounting controls made it impracticable for us to carry out sufficient auditing tests and procedures which we deemed necessary to comply with generally accepted auditing standards. Accordingly, there can be no assurance that the aforementioned accounting information is reliable.

Related party investigation

The Official Creditors' Committees, with the approval of the Bankruptcy Court, have retained another firm of independent certified public accountants to perform an investigation (currently in progress) of transactions with related parties. Because of this independent investigation, at the request of management, the scope of our examination for 1978 did not include the application of all the audit procedures prescribed in Statement on Auditing Standards No. 6, "Related Party Transactions." Such procedures are required by generally accepted auditing standards to enable us to make judgments as to the disclosures in Note 3 and to make judgments as to the effect, if any, of such transactions on the financial statements, other disclosures or other aspects of our examination.

UNCERTAINTIES AFFECTING FINANCIAL STATEMENTS

Chapter XI proceedings and going concern basis of accounting

As more fully described in Note 1, on October 2, 1978, the Company and nine of its wholly owned subsidiaries filed Petitions for an Arrangement under Chapter XI of the Bankruptcy Act and were authorized to continue the businesses as Debtors-in-Possession. Chapter XI provides for submission to the Bankruptcy Court and creditors of a Plan of Arrangement setting forth proposed terms for satisfaction of debts. There can be no assurance at this time that a Plan, when formulated and submitted, will be accepted by creditors or confirmed by the Court. If the Chapter XI proceedings are not concluded by confirmation of the Plan, it is possible that the Chapter XI proceedings will be transferred to the corporate reorganization provisions of Chapter X of the Act and a trustee appointed or the Company will be adjudicated bankrupt and its assets liquidated. The assets and liabilities on the accompanying balance sheet do not give effect to adjustments that may have been required had the outcome of the Chapter XI proceedings been known.

The accompanying financial statements have been prepared on the basis of accounting principles applicable to a going concern. However, as discussed above, the Company is operating as a Debtor-in-Possession under the Bankruptcy Act. As discussed in Note 1, subsequent to July 29, 1978 the Company terminated its supermarket operations in the Connecticut, New York, New Jersey, Pennsylvania and Western Florida areas and has offered its discount department store division for sale. Significant operating losses and losses on disposition have been incurred to date. Should the Company be adjudicated bankrupt and be unable to continue any of its operations, it would be required to realize its remaining assets and liquidate its remaining liabilities in other than the normal course of business, at amounts which may be materially different from those reflected in the accompanying financial statements.

Legal proceedings and contingencies

At July 29, 1978 and July 30, 1977, the Company was involved in certain matters the outcome of which is not susceptible to reasonable estimation. These matters consist of the recovery of workmen's compensation, automobile and general liability claims paid in excess of the deductible amount provided in the related insurance policies ($8,445,000 at July 29, 1978 and $5,289,000 at July 30, 1977); the adequacy of the estimated liability of $1,594,000 at July 29, 1978 and $650,000 at July 30, 1977 for payments to claimants under the Company's policy of self-insuring individual claims of $100,000 ($250,000 subsequent to July 10, 1978) or less for the aforementioned risks; adjustments proposed by the Internal Revenue Service for additional federal income taxes (approximately $9,600,000 at July 29, 1978 and $6,200,000 at July 30, 1977); and an action alleging violations of certain sections of the federal securities laws and common law principles.

In 1977 the Company was named as a defendant in multiple civil actions alleging violations of the antitrust laws in connection with the purchase and resale of beef. The outcome of these actions is presently uncertain.

Subsequent to July 29, 1978, the Company was named a defendant in several class and derivative actions and was issued a notice for additional state sales and use taxes.

The ultimate outcome of the above matters cannot be determined at this time and the financial statements contain no provision for any liability (other than the aforementioned estimated liability for self-insured risks) that may result.

Operations discontinued subsequent to July 29, 1978

The closing of a significant portion of the Company's supermarket operations subsequent to July 29, 1978, together with management's estimate of the resulting operating losses from July 30, 1978 to the date of closing and losses upon disposition are described in Note 1. Since the losses from operations have been estimated based upon interim financial data and the losses upon disposition are largely prospective in nature, the amounts presented in Note 1 (which will be recognized in financial statements for a period or periods subsequent to July 29, 1978) are subject to future revision.

INCOMPLETE DISCLOSURES

The Company has not disclosed the aggregate effect of year-end adjustments on the results of operations for the fourth quarter of 1978. Omission of this disclosure is a departure from generally accepted accounting principles. Further, disclosure of quarterly financial data for 1978, required by the Securities and Exchange Commission to be included in reports to shareholders, has been omitted (see Note 17).

The disclosures related to leases in effect at July 29, 1978, as presented in Note 15, do not include the information required by Statement of Financial Accounting Standards No. 13, "Accounting for Leases." The omitted disclosures relate to, among other things, rentals charged to operations for 1978 and 1977, aggregate future rental commitments, and the transitional disclosure requirements related to the capitalization of leases that will result from retroactive application of the Statement. These omissions are a departure from generally accepted accounting principles.

DISCLAIMER OF OPINION

In our report dated October 29, 1977, we qualified our opinion stating that the 1977 financial statements were subject to the effects of such adjustments, if any, as might have been required had the outcome of various uncertainties been known. Additional uncertainties have arisen subsequent to our report date. Because of the significance of the matters discussed above under "Uncertainties Affecting Financial Statements", principally the filing on October 2, 1978 of the Petition for an Arrangement under Chapter XI and events subsequent thereto, we are not at this time able to express, and we do not express, an opinion on the 1977 financial statements and supporting schedules referred to in the opening paragraph above.

Because of the significance of the matters discussed above under "Restrictions in Scope of Examination for 1978" and "Uncertainties Affecting Financial Statements," we are not able to express, and we do not express, an opinion on the 1978 financial statements and supporting schedules referred to in the opening paragraph above.

LAVENTHOL & HORWATH

Philadelphia, Pa.
March 9, 1979

FOOD FAIR, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

July 29, 1978 and July 30, 1977

NOTES 1 AND 20

ASSETS

	1978	1977 (Restated, Note 2)
	(In thousands)	
Current assets:		
Cash	$ 18,604	$ 10,630
Accounts receivable, net of allowance for doubtful accounts of $2,062, 1978 and $1,057, 1977 (Note 8)	18,939	22,608
Inventories (Note 2)	267,063	261,439
Prepaid expenses	9,265	10,814
Refundable income taxes	1,078	1,327
Total current assets	314,949	306,818
Investments (Notes 2, 7 and 8)	13,157	14,756
Property and equipment (Notes 2, 8, 9 and 15):		
Land	27,499	27,749
Buildings	90,660	93,912
Capitalized leased assets	18,434	
Leasehold improvements	57,572	57,017
Fixtures and equipment	129,084	143,445
	323,249	322,123
Less accumulated depreciation and amortization	150,479	150,094
	172,770	172,029
Accounts and notes receivable, not current (Notes 4 and 8)	12,984	7,685
Other assets (Note 2)	6,432	6,279
	$520,292	$507,567

See notes to consolidated financial statements.

FOOD FAIR, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

July 29, 1978 and July 30, 1977

NOTES 1 AND 20

LIABILITIES AND SHAREHOLDERS' EQUITY

	1978	1977 (Restated, Note 2)
	(in thousands)	
Current liabilities:		
Notes payable (Note 8)	$ 36,685	$ 18,416
Current portion:		
Long-term debt (Note 9)	124,954	18,279
Capitalized lease obligations	1,463	
Accounts payable	146,078	104,889
Accrued salaries and expenses (Note 4)	47,373	39,131
Income taxes (Notes 2 and 13)		3,219
Total current liabilities	356,553	183,934
Long-term debt (Note 9)	58,147	173,123
Capitalized lease obligations	16,265	
Deferred income (Note 10)	1,140	1,379
Deferred income tax (Notes 2 and 13)	1,771	8,259
Minority interest	141	416
Commitments and contingencies (Note 4)		
Shareholders' equity (Notes 2, 9, 11 and 12):		
Preferred stock	1,627	1,747
Common stock	7,557	7,557
Capital in excess of par	51,239	51,239
Retained earnings	27,189	81,250
	87,612	141,793
Less cost of common stock in treasury	1,337	1,337
	86,275	140,456
	$520,292	$507,567

See notes to consolidated financial statements.

FOOD FAIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Fifty-two Weeks Ended July 29, 1978 and July 30, 1977

NOTES 1 AND 20

	1978	1977 (Restated, Note 2)
	(In thousands except per share amounts)	
Sales	$2,785,899	$2,436,702
Cost of sales	2,252,832	1,943,405
Gross profit	533,067	493,297
Operating and administrative expenses	580,897	477,600
Income (loss) from operations	(47,830)	15,697
Interest expense, net	(20,758)	(14,603)
Gain on disposition of property and equipment	6,797	916
Other income, net (Note 7)	497	479
Income (loss) before income tax benefits	(61,294)	2,489
Income tax benefits (Note 13)	8,776	757
Income (loss) before cumulative effect of changes in accounting methods	(52,518)	3,246
Cumulative effect on prior years of changes in accounting methods (Note 5)		4,175
Net income (loss)	($ 52,518)	$ 7,421
Income (loss) per share of common stock:		
Income (loss) before cumulative effect of changes in accounting methods	($ 7.13)	$ .43
Cumulative effect of changes in accounting methods		.57
Net income (loss)	($ 7.13)	$ 1.00
Pro forma amounts assuming the 1977 methods of accounting were applied retroactively (Note 5):		
Income before cumulative effect of changes in accounting methods and net income		$ 3,246
Income per share of common stock		$ .43

See notes to consolidated financial statements.

FOOD FAIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Fifty-two Weeks Ended July 29, 1978 and July 30, 1977

NOTES 1 AND 20

	1978	1977 (Restated, Note 2)
	(In thousands)	
Balance, beginning	$81,250	$75,377
Net income (loss)	(52,518)	7,421
	28,732	82,798
Cash dividends paid:		
Preferred stock ($4.20 per share)	71	76
Common stock ($.20 per share)	1,472	1,472
Balance, ending	1,543	1,548
	$27,189	$81,250

See notes to consolidated financial statements.

FOOD FAIR, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Fifty-two Weeks Ended July 29, 1978 and July 30, 1977

NOTES 1 AND 20

	1978	1977 (Restated, Note 2)
	(In thousands)	
Source of funds:		
Net income (loss) for the year	($ 52,518)	$ 7,421
Items not affecting working capital:		
Depreciation and amortization	21,336	19,974
Deferred income	(239)	(239)
Deferred income tax	(6,488)	(2,095)
Equity in undistributed earnings of unconsolidated subsidiaries	(208)	(738)
Gain on disposition of property and equipment	(6,797)	(916)
Working capital provided from (required by) operations	(44,914)	23,407
Proceeds from:		
Disposition of property and equipment	16,555	3,923
Long-term borrowings	12,174	42,453
Capitalized lease obligations	17,729	
Repayment of subordinated notes and advances from unconsolidated subsidiaries		8,834
Other, net	1,112	560
	2,656	79,177
Application of funds:		
Purchase of property and equipment	31,862	16,229
Decrease in long-term debt	29,433	26,231
Reclassification of long-term debt	99,007	
Increase in receivables, not current	5,299	3,179
Payment of cash dividends	1,543	1,548
Equity in net noncurrent assets of subsidiaries acquired		4,482
	167,144	51,669
Increase (decrease) in working capital	($164,488)	$27,508
Working capital changes, increase (decrease):		
Cash	$ 7,974	($ 6,120)
Accounts receivable	(3,669)	2,082
Inventories	5,624	23,579
Prepaid expenses	(1,549)	685
Income taxes	2,970	2,213
Notes payable	(18,269)	12,106
Current portion of long-term debt	(108,138)	(5,619)
Accounts payable	(41,189)	(2,709)
Accrued salaries and expenses	(8,242)	1,291
Increase (decrease) in working capital	($164,488)	$27,508

See notes to consolidated financial statements.

1. Chapter XI proceedings and subsequent events (See Note 20):

As a result of severe liquidity problems caused by unprofitable operations, both prior and subsequent to July 29, 1978, and the failure of suppliers to continue to extend normal trade credit terms, the Company and nine of its wholly owned subsidiaries filed, on October 2, 1978, Petitions for an Arrangement (Petition) under Chapter XI of the Bankruptcy Act (Act) in the United States District Court, Southern District of New York (Court). By order so dated, the Company has been authorized to continue to operate its businesses as Debtor-in-Possession, subject to the control and supervision of the Court.

The Company is presently formulating a Plan of Arrangement (Plan) which will set forth the proposed terms for payment to creditors. There can be no assurance at this time that a Plan will be accepted by creditors or confirmed by the Court. If such Plan is not accepted and confirmed, the possibilities exist that the Chapter XI proceedings will be transferred to the corporate reorganization provisions of Chapter X of the Act and a trustee appointed or the Company will be adjudicated bankrupt and its assets liquidated.

On or about November 1, 1978, with the approval of the Court, the Company closed all its 89 remaining supermarkets in the metropolitan New York area. The Company has also closed 15 other isolated unprofitable supermarkets as well as certain support facilities. Sales attributable to the aforementioned 104 stores approximated $400,000,000 in 1978. Management estimates that losses of approximately $11,400,000 were incurred from the operation of the stores from July 30, 1978 to the date of closing and that a loss of approximately $11,300,000 will result from the disposition of these operations. This estimated loss upon disposition does not consider (1) any costs or benefits that may result from adjustments to pension plans administered by the Company or obligations for pension benefits arising out of collective bargaining agreements or (2) any gains or losses which may result from the sale of closed stores in which the Company has a direct or indirect equity interest. Further, the ultimate gain or loss to be incurred upon disposition is subject to significant uncertainties and possible future adjustment as it is largely prospective in nature.

On January 26, 1979, the Court approved the Company's decision to close all of its remaining 123 supermarkets in the Philadelphia and Harrisburg, Pennsylvania and Tampa and Clearwater, Florida areas. Sales attributable to these stores approximated $600,000,000 in 1978. Management estimates that losses of approximately $14,300,000 were incurred from the operation of these stores from July 30, 1978 to the date of closing. It is not presently practicable to estimate the gain or loss which may result from the disposition of these operations.

The Company has also announced its intention to seek buyers for its J.M. Fields and related discount general merchandise operations. Sales of this segment for 1978 approximated $400,000,000. Because the date of disposition is not determinable, it is not presently practicable to estimate the results of operations to the date of closing or the gain or loss to be realized upon disposition.

Additionally, at July 29, 1978, the Company owns or leases, directly or through subsidiaries, approximately 100 properties which had formerly been operating supermarkets or department stores. Many of the owned properties have been leased and leased properties subleased, although some are idle. The Company is in the process of evaluating all such properties for retention or disposition. In the past, the Company has generally been able to sublease or otherwise dispose of idle properties on terms sufficient to substantially recover costs. There is no assurance that the Company will continue to be able to do so.

The Company has deposited, into a special trust fund authorized by the Court, the first $25 million of net proceeds from the disposal of real estate, lease rights and equipment and from the liquidation of inventories related to facility closings, as security for credit extended subsequent to October 1, 1978. The excess of proceeds above $25 million, approximately $900,000 at March 9, 1979, is to be segregated and held apart at interest subject to further order of the Court.

The accompanying financial statements do not give effect to the losses resulting from operations and disposal of the aforementioned discontinued businesses subsequent to July 29, 1978, nor do they provide for the effects of any transaction or event resulting from the filing of the Petition. Rent and other occupancy costs to be incurred in connection with the closing of leased facilities have been estimated considering the relief provisions of the Act. The Act permits the disaffirmance of leases whereby the Company's liability is limited to three years rent, commencing with the earlier of reentry by the landlord or surrender of the premises, plus unpaid rent to such date.

These financial statements have been prepared on the basis of principles of accounting applicable to a going concern. The continuation of the Company as a going concern is contingent upon, among other factors, its ability to (1) formulate and file a Plan which will gain the approval of the creditors and confirmation of the Court, (2) generate sufficient cash to effectuate the Plan, (3) achieve sustained profitable operations and (4) establish and continue normal trade credit terms with its suppliers. Although there can be no assurances, management believes that the Company has the ability to satisfy these requirements.

For events subsequent to March 9, 1979 [date of Accountants' Report], see Note 20 (unaudited).

2. Summary of significant accounting policies:

Fiscal year:

The fiscal year (year) of the Company ends on the Saturday nearest July 31. The 1978 and 1977 years each comprise 52 weeks.

Basis of consolidation:

The financial statements include the accounts of the Company and its wholly and majority owned subsidiaries, except its life insurance company and credit company. All significant intercompany balances and transactions have been eliminated. This elimination in 1978 necessitated a charge of $2,321,000 to operating and administrative expenses, representing the unreconciled excess of receivables over payables among the Company and its consolidated subsidiaries at July 29, 1978.

During the year ended July 29, 1978 and subsequent thereto, a significant number of facilities owned by Realmart, Inc. (Realmart), an affiliate whose primary business is leasing supermarket facilities to the Company, were closed. Because the closing of facilities has changed the Company's business and investment relationships with Realmart, consolidation of the accounts of Realmart is deemed appropriate. Accordingly, the accounts of Realmart have been included in the financial statements for 1978. This constitutes a change in reporting entity and the 1977 financial statements have been correspondingly restated. Since in prior years the Company's investment in Realmart was accounted for under the equity method, this restatement has no effect on net income or retained earnings as originally reported for 1977.

Investments:

Investments in the life insurance and credit companies, 50% owned companies and the common stock of Amterre Development Inc. (Amterre) are stated at the Company's equity in net assets. The investment in the preferred stock of Amterre is stated at cost, equal to its liquidating value (see Note 7).

Inventories:

Inventories are stated at the lower of cost or market, with cost being determined as follows: Inventories in stores—retail method; inventories in warehouses—principally average cost; inventories at manufacturing facilities and supplies—first-in, first-out method.

Inventories of merchandise used in the determination of cost of sales are as follows:

	(In thousands)
July 31, 1976	$237,860
July 30, 1977	261,439
July 29, 1978	267,063

Property and equipment and depreciation:

Property and equipment is stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, as follows:

Buildings	20-35 years
Leasehold improvements	10-20 years
Fixtures and equipment	3-10 years

Leasehold improvements are amortized over the lesser of the term of the lease or the estimated life of the improvements. Expenditures for maintenance and repairs are charged to operations and major renewals and betterments are capitalized. Costs and related accumulated depreciation of properties sold or otherwise retired have been eliminated from the accounts and gains and losses on disposition are reflected in operations.

The Company has accounted for leases entered into subsequent to January 1, 1977 in accordance with the provisions of Statement of Financial Accounting Standards No. 13. Earlier leases are accounted for in accordance with previously effective accounting principles.

Other assets:

Computer system costs incurred in the acquisition, development or improvement of software related to administrative operations are deferred and amortized over five years.

Income taxes:

Deferred income taxes result from timing differences in the recognition of certain income and expense items for financial reporting and income tax reporting purposes, principally depreciation expense and insurance claims receivable. In 1977, deferred taxes applicable to current assets are included in current liabilities. Investment tax credits are accounted for under the "flow-through" method when the assets are placed in service.

Pension plans:

Pension expense includes normal cost and amortization of prior service costs over a forty year period. Pension costs are funded as accrued.

Income (loss) per share of common stock:

Income (loss) per share of common stock is based on the weighted average number of shares outstanding during each year. Options, warrants and convertible subordinated notes had no significant dilutive effect.

3. Transactions with certain parties:

On December 8, 1978, the Official Creditors' Committees (Committee) received Court authorization to retain a firm of independent certified public accountants to conduct an extensive in-depth investigation of related party transactions. This investigation will include, among other things, a review and analysis of transactions between the Company and (1) entities controlled by or related to it or its present and former officers or directors (including entities in which such present and former officers and directors may have an interest) and (2) stockholders of the Company.

The following disclosures include only those related entities with whom a significant volume of business has been transacted during 1978 and 1977. While there are other related entities with whom business is transacted, management, based on information presently available, believes that the volume of business, direct or indirect, with each is not significant, although in the aggregate it may be. The special investigation, when concluded, may reveal additional information concerning any or all of the aforementioned entities. A detailed report on the results of this investigation is expected to be submitted to the Court, the Committee and the Company upon completion.

Hasam Realty Corp. (Hasam):

The voting stock of Hasam is owned 100% by Samuel Friedland, a former officer and director of the Company, and by members of his family. Hasam is the owner of approximately 14% of the Company's common stock. The Company leases two retail store locations from Hasam under leases which provide for minimum annual rentals of $276,000 through 1990, exclusive of taxes, insurance and other occupancy costs. Rentals of $276,000 were paid under these leases in 1978 and 1977.

Filigree Foods, Inc. (Filigree):

During 1976 Hasam acquired 49% of the common stock of Filigree and warrants to acquire an additional 10%. Filigree, a wholesale grocery company, had previously supplied the Company's supermarkets primarily in the metropolitan New York area prior to their closing (see Note 1). Hasam granted the Company an option, originally exercisable until April 1977 and subsequently extended to April 1979, to acquire Hasam's interest in Filigree for an amount equal to its investment plus carrying costs.

In addition to Hasam's interest in Filigree, Samuel Stein, a member of the firm of Stein Rosen & Ohrenstein, the Company's general counsel, and brother of Louis Stein, a former director of the Company, owns a 10% interest in Filigree.

The Company purchased approximately $123,000,000 and $21,000,000 of groceries from Filigree during 1978 and 1977, respectively.

Richman Associates (Richman):

Richman is a brokerage firm in which Harold Friedland, a former officer and director of the Company, is the controlling partner. Since the Company's records reflect only the purchases from suppliers, and not the identity of any broker who may have represented the suppliers, it is not practicable for the Company to determine the volume of transactions in which Richman acted as broker for suppliers selling to the Company.

MGS Incentives Company (MGS):

In December 1976, the Company sold its interest in MGS to an entity controlled by Harold Friedland, a former officer and director of the Company. MGS has administered certain of the Company's supermarket promotional campaigns. Fees are based upon the value of promotional merchandise utilized. The Company paid MGS $3,400,000 and $200,000 in 1978 and 1977, respectively.

Other:

See Notes 7 and 10 for disclosure of other related parties.

4. Legal proceedings and contingencies:

Under the Chapter XI proceedings described in Note 1, certain actions against the Company may be stayed and enjoined until the Chapter XI case is closed, dismissed or converted to bankruptcy. It is not presently possible to predict the ultimate outcome of the pending matters described below.

Accounts and notes receivable, not current, include $8,445,000 at July 29, 1978 and $5,289,000 at July 30, 1977, which represent the excess of workmen's compensation, automobile and general liability claims and adjustors' fees paid above the deductible amount provided in the related insurance policies. The insurer had denied liability for the claims, and has filed suit seeking to rescind the insurance coverage by alleging misrepresentation of certain information furnished to the insurer prior to issuance of the policies. Counsel for the Company have advised that, on the basis of extensive although not yet complete deposition testimony and other discovery with the principal agents and employees of the insurer, the insurer has not come forward with evidence sufficient to sustain its claim for rescission. The Company has filed counterclaims seeking to recover the excess payments.

The Federal income tax returns of the Company and certain subsidiaries have been examined by the Internal Revenue Service for 1964 through 1972. The Internal Revenue Service has proposed adjustments which would result in additional taxes of approximately $9,600,000 at July 29, 1978 and $6,200,000 at July 30, 1977, exclusive of interest. These issues are currently in dispute.

The Company, as a shareholder of Hamilton Advisors', Inc., which served as an advisor to Hamilton Investment Trust, together with others, was named in March 1977 as a defendant in a class action which alleges violations of certain sections of the Federal Securities Laws as well as common law principles. The plaintiffs seek damages of an unspecified and undetermined amount. The defendants have moved to dismiss the complaint, however, the outcome of this litigation is uncertain.

The Company, together with numerous retail food companies and others, has been named as a defendant in multiple civil actions brought in various United States District Courts by certain cattle producers and feeders alleging violations of the antitrust laws in connection with the purchase and resale of beef. The cases, which have been consolidated for pre-trial purposes in the United States District Court, Northern District of Texas, seek damages in an unspecified amount and an injunction against further antitrust violations as alleged. Management believes that no basis exists for the allegations made against the Company and, after consultation with counsel, is of the opinion that these actions will not have a material adverse effect on the financial condition of the Company. These cases are ultimately expected to be tried before a jury.

Subsequent to July 29, 1978, the Company has been named a defendant in several class and derivative actions (including a derivative action brought by shareholders of Amterre), the majority of which raise allegations primarily concerning impropriety in dealings with related parties and the issuance of misleading financial information and shareholder communications. At this time, no answers to the allegations have been filed and minimal substantive discovery has taken place.

In December 1978, the State of New York Department of Taxation and Finance issued a notice for sales and use taxes due for the period November 19, 1972 through August 31, 1977 in the amount of approximately $4,500,000, plus interest. It is assumed that New York will file an appropriate proof of claim in the Chapter XI proceedings; however, at the present time it is not possible to estimate the ultimate liability that the Company may incur with respect to the asserted deficiencies.

The Company is party to various other claims and lawsuits arising in the normal course of business, the outcome of which, in the opinion of management, will not materially affect the Company's financial condition.

As a result of the unresolved litigation regarding the insurance coverage discussed previously, the Company elected new insurance coverage under which it will self-insure individual claims of $100,000 ($250,000 subsequent to July 10, 1978) or less for workmen's compensation, automobile and general liability risks. An estimate of $1,594,000 and $650,000 is included in current liabilities at July 29, 1978 and July 30, 1977, respectively, for settlement of filed claims. It cannot be determined whether the Company will be required to make payments to claimants in excess of the amounts accrued, and if so required, whether such amounts will be material. Further, additional liabilities for occurrences prior to July 29, 1978 may arise as a result of claims not yet filed.

The Company is contingently liable for accounts receivable sold to banks with recourse of $15,000,000 at July 29, 1978.

5. Accounting changes for 1977:

In the fourth quarter of 1977, the Company changed certain methods of accounting in order to provide a better matching of revenues and expenses and to improve interim financial reporting as follows: (1) the inclusion of warehousing costs in the determination of supermarket inventories; (2) the amortization of payroll tax expense over the entire year; and (3) the computation of deferred income taxes on the gross change method.

Previously, warehousing costs and payroll taxes were charged to income as incurred. Deferred income taxes were recorded on the net change method.

These changes resulted in an increase in 1977's income before cumulative effect of changes in accounting methods of $318,000 (warehouse overhead, $98,000; payroll taxes, $220,000; deferred income taxes, none) or $.04 per share. The cumulative effect of these changes on prior years of approximately $4,175,000 (warehouse overhead, $1,540,000; payroll taxes, $798,000; deferred income taxes, $1,837,000) net of $2,217,000 for income taxes, or $.57 per share, was credited to operations in 1977.

As of July 30, 1977, the Company revised its estimate of the liability for trading stamp redemptions, the effect of which was to increase income before cumulative effect of changes in accounting methods and net income for 1977 by $858,000 or $.12 per share.

6. Acquisitions:

On October 7, 1976, the Company acquired for cash the net assets of 17 supermarkets formerly owned by Penn Fruit Co., Inc. for $3,926,000. The acquisition was accounted for as a purchase and net assets were recorded based upon estimated fair value. Operations of the acquired supermarkets are included in the statement of operations from the date of acquisition. (See Note 1 regarding closing of all Philadelphia area supermarkets subsequent to July 29, 1978.)

On May 7, 1977, the Company acquired for cash all the outstanding capital stock of Hills Supermarkets, Inc. (Hills) for $8,202,000. At the date of acquisition, Hills operated 43 supermarkets in the Long Island, New York area. The acquisition was accounted for as a purchase and the financial statements include the operations of Hills from the date of acquisition. (See Note 1 regarding closing of all metropolitan New York area supermarkets subsequent to July 29, 1978.)

The businesses acquired in the aforementioned transactions were only a portion of the aggregate operations of the two companies in prior periods, and because of the nature and extent of significant adjustments made at the date of the Hills acquisition, it is not practicable to present, on a pro forma basis, combined results of operations for 1977 as though the businesses had been combined as of the beginning of the year. Pro forma combined sales of the Company and the acquired businesses for 1977 approximate $2.6 billion.

7. Investments:

Included in investments are advances to Amterre of $2,311,000 at July 29, 1978 and $1,819,000 at July 30, 1977. Investments are stated principally at equity in net assets as follows:

	1978	1977
	(in thousands)	
Amterre Development Inc (a)	$ 7,321	$ 7,879
Washington Square Life Insurance Co. (b)	4,185	4,543
Other	1,651	2,334
	$13,157	$14,756

(a) The Company owns all the preferred stock and 40% of the common stock of Amterre. At July 29, 1978, the value of the preferred stock was $2,000,000 (Note 2) and the market value of the common stock was $10,000,000 based on a quoted bid price of $3 per share.

Condensed financial data of Amterre follows:

	December 31,	
	1977	1976
	(in thousands)	
Net assets		
Property and equipment, at cost, net	$163,773	$179,069
Indebtedness	(154,889)	(173,187)
Other, net	2,002	6,575
Shareholders' equity	$ 10,886	$ 12,457
Operating results for the year		
Revenues	$ 30,345	$ 29,122
Loss from continuing operations	$ 1,451	$ 341
Net loss	$ 1,451	$ 243

In May 1978, the Board of Directors of Amterre proposed a plan of complete liquidation and dissolution. The plan must be confirmed by a majority vote of all shareholders other than Food Fair and the officers and directors of Food Fair and Amterre. The plan must further be confirmed by a majority vote of all shareholders. If adopted under Section 337 of the Internal Revenue Code, as proposed, the plan must be effected and all assets distributed to shareholders within twelve months of the date of adoption. The matter is expected to be voted upon at Amterre's 1979 shareholders' meeting. Amterre has executed agreements, contingent upon adoption of the plan of liquidation, for the sale of numerous of its properties.

The accountants' report on the examination of the financial statements of Amterre for the year ended December 31, 1977 (issued prior to the proposal of the plan of liquidation) was qualified with respect to Amterre's full recovery of its investments in a parcel of land and certain deferred development costs. Should Amterre's plan of liquidation not be adopted, any loss which might be sustained in the realization of the investments (land and development costs) will not have a material effect on the financial position or results of operations of Food Fair.

The Company's equity in Amterre's loss from continuing operations was $484,000 in 1978 and $267,000 in 1977, which amounts are included in the caption "Other income, net" and have been adjusted to provide for dividends paid on preferred stock. The Company is obligated to Amterre under 85 leases expiring at various dates through 2003.

(b) Washington Square Life Insurance Co. (WSL), a wholly owned subsidiary, provides life, accident and health insurance to the Company's employees and third parties. In addition, WSL administers the Company's basic group life insurance programs. During 1978 WSL advanced the Company $925,000 at 8.5% interest. In settlement thereof, the Company, having obtained the necessary statutory approval, sold two parcels of real estate to WSL at a gain of approximately $600,000. Such gain has not been recognized in the accompanying financial statements.

8. Lines of credit:

Information with respect to lines of credit follows:

	1978	1977
	(In thousands)	
Amounts at end of year:		
Available limits	$24,160	$31,700
Outstanding	$22,660	$ 7,700
Average during the year:		
Outstanding	$20,870	$29,360
Interest rates	8.0%	6.5%
Maximum during the year:		
Outstanding	$36,300	$50,500
Interest rates	9.5%	7.0%

On July 28, 1978, the Company entered into a $28,000,000 revolving credit agreement, currently in default, with a consortium of banks in which funds drawn bear interest at ½% (2½% upon default) above the prime rate. In August 1978, the Company borrowed the full amount available, of which $3,400,000 was used to repay demand indebtedness which was outstanding at July 29, 1978. Under the agreement the Company has pledged, among other things, land and buildings which cost approximately $15,000,000, its investment in and advances to Amterre, notes receivable of $2,641,000 ($836,000, current; $1,805,000, not current) and the right to receive sublease income from 18 properties in Northern New Jersey. (Note 20.)

There were no legal restrictions on the availability of the Company's cash balances at July 29, 1978 or July 30, 1977.

9. Long-term debt:

	Rates	1978	1977	Maturities
		(In thousands)		
Notes:				
Banks (a) (c)	(a)	$ 56,563	$ 55,149	1979-1982
Other	5% to prime plus .5%	7,191	8,835	1979-1984
Mortgages, land and buildings pledged as collateral	4.75%-10.5%	60,647	65,287	1979-2001
Subordinated debentures (c)	4%	10,375	11,204	1979
Subordinated notes (b) (c)	8.5%	17,000	19,000	1984
Sinking fund debentures (b) (c)	8.38%	31,325	31,927	1996
		183,101	191,402	
Less:				
Current portion		25,947	18,279	
Reclassification of long-term portion upon default (c)		99,007		
		$ 58,147	$173,123	

(a) On June 1, 1977, the Company entered into a $50,000,000 unsecured revolving credit agreement with a group of banks of which $50,000,000 and $39,000,000 were outstanding at July 29, 1978 and July 30, 1977, respectively. The loans bear interest at ½% above prime (2½% above prime upon default) and are scheduled to mature on March 31, 1980. Interest rates on remaining notes payable range from 8.5% to a rate equal to 116% of prime.

(b) The Company has the option, in lieu of sinking fund payments, to reduce the notes annually as follows:

Subordinated notes	$2,000,000
Sinking fund debentures	$1,750,000

(c) The agreements and indentures covering the notes and debentures described above contain covenants relating to the payment of cash dividends, the redemption of shares of stock of the Company and the maintenance of specified levels of working capital and shareholders' equity.

At July 29, 1978, the Company was in default of certain restrictive covenants in substantially all of the agreements and, accordingly, $99,007,000 of the outstanding long-term portion of the notes and debentures has been reclassified as current. All retained earnings are restricted as to the payment of dividends.

The Plan of Arrangement currently being formulated, when approved, is expected to result in significant changes in the Company's debt structure. It is not possible to predict the repayment terms of long-term debt which will be included in such Plan.

The aggregate annual maturities of consolidated long-term debt for the five years subsequent to July 29, 1978 are as follows:

Reclassified as current upon default	$99,007,000
Scheduled maturities:	
1979	$25,947,000
1980	5,447,000
1981	5,382,000
1982	5,320,000
1983	4,935,000

10. Deferred income:

In 1976, the Company sold all its data processing programs and certain computer equipment to RMC Group, Inc. (RMC), a company which has managed the Company's electronic data processing operations. The equipment and computer programs acquired by RMC are being utilized to provide similar services to the Company and third parties.

The Company entered into an agreement with RMC to manage and operate its computer operations for a period of seven years. Fees paid to RMC for 1978 and 1977 were $8,319,000 and $7,110,000, respectively, of which $665,000 and $799,000 have been deferred as software development costs. The gain on the 1976 sale of equipment and programs ($1,680,000) was deferred and is being credited to income over the term of the management agreement.

RMC granted the Company an option, exercisable until November 8, 1979, to acquire a 40% stock interest in RMC for $1,000,000. Under the terms of a related voting trust agreement, should this option be exercised, an additional 11% of the outstanding common stock of RMC would be transferred to a trust to be voted by the Company.

11. Commitments:

On January 4, 1979, the Court approved an employment agreement between the Company and its current president and chief executive officer (CEO), under which the Company has paid the CEO $100,000 upon commencement of employment and will pay $350,000 annually for five years. In addition, the Company is obligated, upon termination of the CEO's employment, for annual retirement benefits of $55,000 for the remainder of his or his present wife's life, should she survive him. The Company has also granted him a nontransferable option to acquire up to 200,000 shares of the Company's common stock at $2.00 per share on or before January 2, 1984. The Company has deposited approximately $2,150,000 into trust funds to secure payment under the above contract.

The Company has an employment contract with the president of its J.M. Fields department store division which provides for a minimum annual salary of $200,000 through 1982, plus a bonus based upon the achievement of defined levels of department store earnings up to a maximum annual compensation of $450,000. The officer is obligated to purchase 100,000 shares of the Company's common stock at $5.625 per share through August 1, 1982 and 100,000 shares at $6.00 per share through August 2, 1987. Purchases of the latter shares may not exceed 10,000 shares for each year of employment completed by the officer. No purchases have been made under either agreement. The Company, as Debtor-in-Possession, to date has neither affirmed nor disaffirmed this contract under the Chapter XI proceedings.

12. Capital stock and capital in excess of par:

The $4.20 cumulative preferred stock, $15 par, is stated at the liquidating value of $100 per share; 108,190 shares are authorized, of which 16,265 and 17,465 are outstanding at July 29, 1978 and July 30, 1977, respectively. The Company is obligated to set aside $120,000 semi-annually as a sinking fund for the redemption of the preferred stock, which may be called for this purpose at $100 per share plus accrued dividends. The decrease in preferred stock represents the stated value of shares retired: 1,200 in 1978 and 2,136 in 1977.

Common stock is $1 par; 10,000,000 shares are authorized, of which 7,557,378 are issued and 199,101 are held in the treasury.

At July 29, 1978, warrants to purchase 416,160 shares of common stock were outstanding. These warrants are exercisable at $23.05 per share and expire December 17, 1979. See Note 11 for stock purchase and option agreements.

The increase in capital in excess of par during 1977 represents the excess of stated value over cost of the preferred stock retired.

13. Income taxes:

	1978	1977
	(In thousands)	
Current:		
Federal (benefit)	($ 407)	($2,015)
State	1,338	700
Deferred (benefit)	(9,707)	558
	($ 8,776)	($ 757)

A reconciliation of the income tax benefit with taxes computed at the statutory Federal income tax rate of 48% is as follows:

	1978	1977
	(in thousands)	
Computed "expected" income tax (benefit) expense	($29,421)	$1,195
State income taxes, net of Federal tax effect	696	364
Federal income tax refunds resulting from Internal Revenue Service examinations		(689)
Capital gains rate differential		(102)
Dividend income	(80)	(80)
Investment tax credit		(1,830)
Undistributed earnings of unconsolidated subsidiaries	(100)	433
Net operating loss carryforward	20,170	
Other, net	(41)	(48)
	($ 8,776)	($ 757)

The tax benefit for 1978 has been recognized principally by the recovery of previously provided deferred taxes.

Deferred tax expense results from timing differences in the recognition of revenue and expense for income tax and financial statement purposes. The sources of these differences in 1978 and 1977 and the tax effect of each is as follows:

	1978	1977
	(in thousands)	
Write-off of deferred charges relating to new or remodeled stores previously deducted for income tax purposes		($ 323)
Excess of tax depreciation over straight-line depreciation	($10,750)	38
Recognition for income tax purposes of previously deferred gross profit on installment sales of J.M. Fields, Inc.		(2,151)
Amount of investment credit for income tax purposes over (under) amount allowable for financial reporting purposes	7,449	(1,830)
Current deductions for income tax purposes pertaining to prior period adjustment		481
Excess of cash payments for self-insurance of workmen's compensation over expense for financial reporting purposes	(2,179)	1,920
Excess of Federal income tax benefit for financial reporting purposes over refund for income tax purposes		(663)
Changes in accounting methods resulting in income for financial reporting purposes but not for income tax purposes:		
Warehouse overhead	(1,532)	1,532
Payroll taxes	(948)	948
Write-off for tax purposes of computer system costs which are being amortized for financial reporting purposes		344
Excess of vacation payroll expenses for financial reporting over related amount for income tax purposes		(529)
Provision for bad debts for financial reporting purposes (over) under provision for income tax purposes		361
Other timing differences, net	(1,747)	430
	($ 9,707)	$ 558

The Company and its subsidiaries file a consolidated Federal income tax return. At July 29, 1978, the Company had available for tax purposes net operating loss carryforwards of approximately $55,000,000, principally expiring in 1985. In addition, the Company has available for tax purposes investment tax credit carryforwards of $7,800,000 expiring periodically through 1985.

14. Pension plans:

The Company and its subsidiaries have various noncontributory pension plans covering certain hourly and salaried employees. Pension expense for 1978 and 1977 was $1,585,000 and $1,464,000, respectively. Pension plan costs are funded as accrued.

According to the latest valuations, the actuarially computed value of vested benefits for certain of the plans exceeded fund assets and balance sheet accruals by approximately $5,164,000. The total unfunded prior service cost of all the plans is estimated to be $9,638,000.

It is not presently possible to forecast the effect which the closings described in Note 1 will have on pension plans administered by the Company. Additionally, the Company may be liable for substantial pension benefits to terminated employees under various collective bargaining agreements. The amount of such liability is not presently subject to reasonable estimation.

15. Lease commitments:

The Company is lessee under leases covering retail locations and distribution center properties. Realty lease terms generally range up to 25 years with renewal options available. In addition, the Company leases certain fixtures and equipment used in its operations which expire at various dates through 1986.

As discussed in Note 1, the Company has discontinued its supermarket operations in various geographic areas and has announced its intention to dispose of its J.M. Fields and related discount general merchandise operations. The leases applicable to the properties closed or to be closed will be sold or disaffirmed under the provisions of the Bankruptcy Act. Pending the finalization of such sales or disaffirmances, it is not considered meaningful to present total future lease commitments legally in effect at July 29, 1978 and the other related disclosures required by Statement of Financial Accounting Standards No. 13, Accounting for Leases. Instead, the disclosures presented are limited to the net amounts payable under noncapitalized real estate and equipment leases in effect at July 29, 1978 for operations expected to continue, principally the Baltimore, Maryland and Jacksonville and Miami, Florida area supermarkets and support facilities:

1979	$ 11,800,000
1980	11,600,000
1981	11,300,000
1982	10,600,000
1983	9,500,000
1984 and thereafter	75,800,000
	$130,600,000

16. Industry segments:

The Company's businesses are conducted within two major industry segments: supermarket operations and discount general merchandise operations.

The supermarket segment consists of a chain of retail food stores and related food manufacturing and processing businesses, meat packing and fabricating plants and other miscellaneous operations which supply the Company's supermarkets and also, in certain cases, sell to competing businesses. A chain of discount department stores and related wholesale and manufacturing operations comprise the discount general merchandise operations.

Total revenue by industry segment consists of sales to unaffiliated customers only, as reported in the Company's consolidated statement of operations. Operating loss is total revenue less operating expenses and excludes general corporate expenses, interest expense and income tax benefit.

Identifiable assets by segment are those assets used in the Company's operations in each industry. Corporate assets are principally investments in and advances to unconsolidated subsidiaries, computer systems costs (net of amortization) and workmen's compensation and general liability claims paid in excess of the deductible amount (see Note 4).

Following is a tabulation of the 1978 industry segment data:

	Supermarket operations	Discount general merchandise operations	Consolidated
		(In thousands)	
Sales to unaffiliated customers	$2,386,375	$399,524	$2,785,899
Operating loss	$ 14,208	$ 18,893	$ 33,101
General corporate expenses			7,435
Interest expense			20,758
Loss from operations before income tax benefit			$ 61,294
Identifiable assets	$ 346,915	$144,994	$ 491,909
Corporate assets			28,383
Total assets			$ 520,292
Depreciation and amortization expenses	$ 18,395	$ 2,676	$ 21,071
Capital expenditures:			
Additions to property and equipment	$ 11,763	$ 1,665	$ 13,428
Capitalized leases	13,165	5,269	18,434
Total capital expenditures	$ 24,928	$ 6,934	$ 31,862

17. Selected quarterly financial data (unaudited):

The Company is presently reviewing the quarterly financial statements for the year ended July 29, 1978. The results of the review will be disclosed upon completion.

Quarterly condensed financial data for 1977 follows:

	Quarter ended			
	November 20, 1976 (16 weeks)	February 12, 1977 (12 weeks)	May 7, 1977 (12 weeks)	July 30, 1977 (12 weeks)
	(In thousands, except per share amounts)			
Net sales	$734.991	$586.718	$528.387	$586,606
Gross profit	$151.338	$126,217	$107.527	$108,215
Income (loss) before cumulative effect of changes in accounting methods	$ 2.047	$ 3.230	$ 912	($ 2,943)
Net income (loss)	$ 6,269	$ 3,073	$ 1,377	($ 3,298)
Earnings (loss) per share of common stock:				
Before cumulative effect of change in accounting methods	$.28	$.44	$.12	($.41)
Net income (loss)	$ 85	$.42	$.18	($.45)

The quarter ended November 20, 1976 includes $4,175,000 ($.57 per share) for the cumulative effect of the changes in accounting methods described in Note 5. The revised estimate of the liability for trading stamp redemptions described in Note 5 is included in income (loss) before cumulative effect of changes in accounting methods of the quarter ended July 30, 1977.

18. Replacement cost information (unaudited):

In accordance with the rules of the Securities and Exchange Commission, the Company has estimated replacement cost information for certain inventories and property and equipment of its operations, together with the effect which replacement cost would have on cost of sales and depreciation expense.

While the disclosure is meant to aid investors in appraising the impact of inflation on the operations and financial position of the Company, the SEC cautioned investors and analysts, in its release, against simplistic use of replacement cost information. In issuing that warning, the SEC "intentionally determined not to require the disclosure of the effect on net income of calculating cost of sales and depreciation on a current replacement cost basis, both because there are substantial theoretical problems in determining an income effect and because it did not believe that users should be encouraged to convert the data into a single revised net income figure. The data is not designed to be a simple road map to the determination of true income. In addition, investors must understand that due to the subjective judgments and the many different specific factual circumstances involved, the data will not be fully comparable among companies and will be subject to errors of estimation."

The Company believes that inherent imprecision in and general limitations on the usefulness of the replacement cost information required by the rule, apply specifically to the Company's replacement cost information presented herewith.

Subsequent to July 29, 1978, the Company closed a significant portion of its operations as described in Note 1 and, accordingly, has excluded those related facilities from the replacement cost data at July 29, 1978. As discussed in Note 2 the accounts of Realmart, Inc. (Realmart) have been included in the financial statements for 1978 and 1977 and as a result of this change in reporting entity, the replacement cost as previously reported for 1977 has been restated.

The replacement cost information is based on the hypothetical assumption that the Company would replace its entire inventory and productive capacity at the end of its fiscal years, whether or not the funds to do so were available or such instant replacement were physically possible. This assumption requires that management contemplate many actions at the end of each year that ordinarily would not be addressed all at one time. Accordingly, the information should not be interpreted to indicate that the Company actually has present plans to replace its productive capacity or that actual replacement would or could take place in the manner assumed in estimating the information. In the normal course of business, the Company will replace its productive capacity over an extended period of time. Decisions concerning replacement will be made in the light of economic, regulatory, and competitive conditions existing on the dates such determinations are made and could differ substantially from the assumptions on which the data included herein are based.

The Company's productive capacity consists of the gross area of its retail stores and associated support facilities, including warehouses, transportation fleet, food processing plants, and administrative offices. Such productive capacity includes all owned buildings, equipment, fixtures and leasehold improvements, plus property (principally retail stores) leased, which meet the requirements of capital leases as defined by Statement of Financial Accounting Standard No. 13 "Accounting for Leases" (SFAS 13). For 1977, the estimated replacement cost of property and equipment has been restated to comply with the requirements of capitalized leases under SFAS No. 13. Excluded also from productive capacity, as specified by the SEC, are land owned by the Company and property leased under operating leases.

The estimated replacement cost of the Company's retail store facilities, including related fixturing and equipment, was developed by determining the amount of square footage required to produce projected sales volumes. After determining the square footage requirements, the above items were priced at current costs. The Company has been engaged in the process of opening more modern and larger stores and phasing out smaller and less efficient units. Accordingly, the assumed replacement of productive capacity requires a smaller number of stores to provide the needed square footage.

As to support facilities, the replacement cost figures were determined by utilizing both direct pricing methods for distribution equipment as well as wholesale price indexes and industrial construction indexes for warehousing, food processing and office facilities. Historical leasehold improvement costs relating to operating leases for retail facilities have also been estimated using cost indexes. It is believed the use of these methods result in a reasonable approximation of replacement cost of these assets, however, the Company disclaims any responsibility for the accuracy, consistency, weighting or other factors which may affect such indexes.

Depreciated productive capacity and current year depreciation related to the replacement cost of assets have been estimated using the straight-line method based on depreciable lives used in calculating historical cost depreciation.

Approximately 62% of the Company's inventories at July 29, 1978 and July 30, 1977 represent grocery store merchandise and perishable foods which have such a high inventory turnover rate that the cost as shown in the financial statement approximates its current replacement cost.

The Company's remaining inventories at 1978 and 1977 were revalued based upon wholesale price indexes. These revaluations disclosed no significant differences between the historical costs and current replacement costs of the inventories.

Likewise, the combination of rapid turnover of inventories and moderate changes in costs resulted in no significant differences between cost of sales included in the financial statements and such costs computed on a current replacement basis. Accordingly, the 1977 replacement cost data has been restated to reflect the same.

The replacement cost data presented below does not reflect any operating cost savings which may result from the replacement of existing assets with assets of improved technology. If the Company's productive capacity were to be replaced in the manner assumed in the calculations of replacement cost of existing productive capacity, many costs other than depreciation (direct labor costs, repairs, maintenance, utility and other indirect costs) would be decreased. Although these expected cost reductions cannot be quantified with any precision, the current level of operating costs other than depreciation could be reduced as a result of improvements in the use of space assumed in the hypothetical replacement.

Further, consideration of the replacement cost information alone does not recognize the customary relationship between cost changes and changes in selling prices to maintain profit margins. The Company has historically been able to maintain its gross margin percentages in periods of inflation.

As a result of additional borrowings to finance part of the cost of the hypothetical replacement, interest costs would increase substantially. However, no increased interest cost effect has been calculated because of the Company's inability to determine the method of financing the replacement. Also, income taxes and the effects of the substantial investment tax credits which would result from the replacement of productive capacity have not been calculated.

The following table reconciles the historical cost amounts for which replacement costs data have been provided with the related totals shown in the consolidated balance sheet and earnings statement:

	Inventories	Productive capacity, gross	Productive capacity, net	Cost of merchandise sold	Depreciation
			(in millions)		
Historical cost amounts, July 29, 1978	$267.1	$323.2	$172.8	$2,252.8	$21.1
Less:					
Land		27.5	27.5		
Facilities not to be replaced as described in Note 1	195.0	160.5	78.2	1,651.8	13.3
Subtotal	72.1	135.2	67.1	601.0	7.8
Plus:					
Value of pre-January 1, 1977 capitalizable leases under SFAS No. 13		87.8	40.6		6.1
Historical costs for which replacement costs have been provided	$ 72.1	$223.0	$107.7	$ 601.0	$13.9
Replacement costs of productive capacity	$ 72.1	$331.5	$175.0	$ 601.0	$18.8
Historical cost amounts, July 30, 1977	$261.4	$322.1	$172.0	$1,943.4	$19.7
Less:					
Land		27.7	27.7		
Nonproductive assets		3.6	1.1		.4
Subtotal	261.4	290.8	143.2	1,943.4	19.3
Plus:					
Value of pre-January 1, 1977 capitalized leases under SFAS No. 13		137.1	115.4		6.2
Historical costs for which replacement costs have been provided	$261.4	$427.9	$258.6	$1,943.4	$25.5
Replacement costs of productive capacity	$261.4	$511.1	$287.1	$1,943.4	$30.4

19. Supplementary statement of operations information:

	Fifty-two weeks ended	
	July 29, 1978	July 30, 1977
	(in thousands)	
Taxes other than income:		
Payroll	$20,661	$20,709
State, local and other	3,452	4,015
Real estate	5,524	6,217
Rents	30,859	32,295
Advertising	40,557	37,908

20. Events subsequent to the date of the report of independent accountants (unaudited):

Subsequent to the date of the independent accountants' report the Company completed closing its books for the twenty-eight weeks ended February 10, 1979, and has prepared Form 10-Q for the period then ended, which it is filing simultaneously with this Form 10-K. Neither the financial information disclosed herein nor Form 10-Q have been reviewed by Laventhol & Horwath. Results of operations for the twenty-eight weeks ended February 10, 1979, are summarized as follows:

Fifty-two Weeks Ended July 29, 1978 and July 30, 1977

	Continuing operations	Closed operations	Total
	(in thousands, except per share amounts)		
Sales	$554,384	$443,321	$997,705
Loss from continuing and closed operations	$ 14,545	$ 60,021	$ 74,566
Loss from discontinued operations			42,063
Net loss			$116,629
Loss per share of common stock:			
Continuing and closed operations	$ 1.98	$ 8.15	$ 10.13
Discontinued operations			5.72
Net loss			$ 15.85

The closed operations include supermarkets and other support facilities closed subsequent to July 29, 1978, as more fully discussed in Note 1. Included in the discontinued operations are the 79 J.M. Fields discount department stores and its footwear operations which sell through the stores. Management estimates that the proceeds from the disposition of all of the closed and discontinued operations should be sufficient to substantially recover costs which include fixed asset-carrying values, costs incurred to maintain these assets and losses from operations during the phase-out period. As a result, no reserve has been provided, however, the ultimate gain or loss to be incurred upon disposition is subject to significant uncertainties.

The Company's deficiency in assets at February 10, 1979, is as follows (in thousands):

Preferred stock	$ 1,622
Common stock	7,557
Capital in excess of par	51,239
Deficit	(126,478)
	(66,060)
Less cost of common stock in treasury	1,337
	$ (67,397)

On May 25, 1979, the Company repaid early a $28 million loan including $2.4 million of interest to certain secured creditors.

FOOD FAIR, INC. AND SUBSIDIARIES

SCHEDULE II—AMOUNTS RECEIVABLE FROM UNDERWRITERS, PROMOTERS, DIRECTORS, OFFICERS, EMPLOYEES AND PRINCIPAL HOLDERS (OTHER THAN AFFILIATES) OF EQUITY SECURITIES OF THE PERSON AND ITS AFFILIATES

Column A	Column B	Column C	Column D		Column E	
			Deductions		Balance at close of period	
Name of debtor	Balance at beginning of period	Additions	(1) Amounts collected	(2) Amounts written off	(1) Current	(2) Not current
Fifty-two weeks ended July 29, 1978:						
Elmer DiFillipo		$ 25,000	$ 10,000		$ 15,000	
Herbert Zandler	$ 22,500				22,500	
Edward Shulkin	13,025		13,025			
George Pope	25,000		25,000			
Jack Millman	27,000				27,000	
Henry Kirschner	27,400		9,600		17,800	
Roy Reiner	40,000				40,000	
	$154,925	$ 25,000	$ 57,625		$122,300	
Fifty-two weeks ended July 30, 1977:						
Alfred Murter	$ 25,000		$ 25,000			
Jack Friedland	23,000		23,000			
Harold Friedland	28,000		28,000			
Robert Hertzog		$ 25,000	25,000			
Alfred Beitz		25,000	25,000			
Herbert Zandler		32,500	10,000		$ 22,500	
Edward Shulkin		30,000	16,975		13,025	
George Pope		25,000			25,000	
Jack Millman		27,000			27,000	
Henry Kirschner		27,400			27,400	
Roy Reiner		40,000			40,000	
	$ 76,000	$231,900	$152,975		$154,925	

Note: Each of the above individuals is either a director, officer or employee of the Company.

FOOD FAIR, INC. AND SUBSIDIARIES

SCHEDULE V—PROPERTY AND EQUIPMENT

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at beginning of period	Additions at cost	Retirements	Other changes—add (deduct)—describe	Balance at end of period
			(In Thousands of Dollars)		
Fifty-two weeks ended July 29, 1978:					
Land	$ 27,749	$ 773	$ 1,052	$ 29 (b)	$ 27,499
Buildings	93,912	321	4,611	(42)(a) 1,080 (b)	90,660
Improvements to leased property	57,017	6,908	2,994	(2,341)(a) (1,018)(b)	57,572
Fixtures and equipment	131,724	4,674	12,333	(5,492)(a) (91)(b)	118,482
Automobiles and trucks	11,721	752	1,852	(19)(a)	10,602
Leased assets under capitalized leases		18,434			18,434
	$322,123	$31,862	$22,842	($ 7,894)	$323,249
Fifty-two weeks ended July 30, 1977:					
Land (d)	$ 27,371	$ 647	$ 298	$ 29 (c)	$ 27,749
Buildings (d)	94,028	769	844	(41)(a)	93,912
Improvements to leased property	45,326	6,063	1,186	(1,268)(a) 8,082 (c)	57,017
Fixtures and equipment	119,906	8,176	2,072	(9,516)(a) 15,230 (c)	131,724
Automobiles and trucks	11,109	574	418	(11)(a) 467 (c)	11,721
	$297,740	$16,229	$ 4,818	$12,972	$322,123

(a) Write-off of fully depreciated assets.
(b) Reclassifications.
(c) Balance of purchased businesses at date of acquisition.
(d) Restated, see Note 2.

SCHEDULE VI—ACCUMULATED DEPRECIATION, DEPLETION AND AMORTIZATION OF PROPERTY AND EQUIPMENT

Column A	Column B	Column C	Column D	Column E	Column F
Description	Balance at beginning of period	Additions charged to costs and expenses	Retirements	Other changes—add (deduct)—describe	Balance at end of period
			(In Thousands of Dollars)		
Fifty-two weeks ended July 29, 1978:					
Buildings	$ 41,535	$ 3,054	($ 2,818)	$ 18 (b)	
				(42)(a)	$ 41,747
Improvements to leased property	25,955	4,151	(1,079)	(2,341)(a)	
				(24)(b)	26,662
Fixtures and equipment	74,493	11,926	(7,990)	(5,492)(a)	
				6 (b)	72,943
Automobiles and trucks	8,111	1,142	(905)	(19)(a)	8,329
Leased assets under capitalized leases	—	798			798
	$150,094	$21,071	($12,792)	($7,894)	$150,479
Fifty-two weeks ended July 30, 1977(d):					
Buildings	$ 38,816	$ 3,065	($ 305)	($ 41)(a)	$ 41,535
Improvements to leased property	19,939	3,424	(418)	(1,268)(a)	
				4,278 (c)	25,955
Fixtures and equipment	64,366	12,011	(783)	(9,516)(a)	
				8,415 (c)	74,493
Automobiles and trucks	6,977	1,176	(311)	(11)(a)	
				280 (c)	8,111
	$130,098	$19,676	($ 1,817)	$2,137	$150,094

(a) Write-off of fully depreciated assets.
(b) Reclassifications.
(c) Balance of purchased businesses at date of acquisition.
(d) Restated, see Note 2.

FOOD FAIR, INC. AND SUBSIDIARIES

SCHEDULE XII—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

Column A	Column B	Column C		Column D	Column E
		Additions			
Description	Balance at beginning of period	(1) Charged to costs and expenses	(2) Charged to other accounts—describe	Deductions—describe	Balance at end of period
		(In Thousands of Dollars)			
Fifty-two weeks ended July 29, 1978:					
Allowance for doubtful accounts	$1,057	$1,690(a)		$ 685(b)	$2,062
Fifty-two weeks ended July 30, 1977:					
Allowance for doubtful accounts	$ 698	$2,520(a)	$ 584(c)	$2,745(b)	$1,057

	1978	1977
(a) Increase in reserve (above)	$1,690	$2,520
Charged directly to bad debt expense	2,543	344
Total bad debt expense	$4,233	$2,864

(b) Write-off of uncollectible accounts.

(c) Balance of purchased businesses at date of acquisition.

April 25, 1979

Mr. Grant C. Gentry, President
Food Fair, Inc.
Philadelphia, Pennsylvania

Dear Mr. Gentry:

At your request, we have consulted with you and Messrs. McChesney and Grigsby of current senior management as to your determination of the effects of certain fiscal year 1978 adjusting journal entries on reported quarterly financial information within the year 1978. Our basis for consulting with senior management was our discussions of the nature of the adjustments with former financial management and other Food Fair employees and our reading certain documents and analyses and the Company's financial statements as of and for the year ended July 29, 1978, and the accompanying March 9, 1979 report of Laventhol & Horwath, the Company's independent auditors, on their examination thereof. We did not verify underlying data or perform procedures we would consider necessary to review quarterly financial information in accordance with generally accepted auditing standards. An examination of financial statements is normally a prerequisite for such a review, and we have not made such an examination.

CONCLUSIONS:

Based on our discussions and our reading of certain documents including the 1978 quarterly financial statements on Form 10-Q and closing journal entries and underlying analyses for certain journal entries and the conclusions contained in the aforementioned report of Laventhol & Horwath regarding deficiencies in internal accounting control, we have the following observations and conclusions:

A. The deficiencies in internal accounting control during 1978 reported by Laventhol & Horwath were such that there can be no reasonable assurance that 1978 quarterly financial information issued by the Company is reliable. Consistent with the findings of Laventhol & Horwath, we have observed, in the course of our consulting activities, the difficulties experienced by client personnel in attempting to correct or validate information which was prepared in error, apparently because of the same deficiencies.

B. The condition of the system of internal accounting control and the nature and magnitude of the adjustments summarized elsewhere herein signify that material portions of adjustments recorded in the fourth quarter of the fiscal year ended July 29, 1978 pertain to earlier periods.

C. It may not be possible to restate the previously reported quarterly results or the results for the year ended July 29, 1978 since many of the employees who participated in the preparation of the previously issued financial information and underlying accounting records are no longer employed by the Company. In addition, we have been informed by present employees that they frequently are unable to locate documents supporting recorded accounting entries. Also, as a result of the condition of the internal reporting systems and the state of maintenance of the accounting records, Laventhol & Horwath explained in their report that they were unable to perform all of the auditing procedures that they considered necessary to complete their examination of the financial statements as of and for the year ended July 29, 1978. In view of the foregoing factors, we believe reconstruction of available records to appropriately restate previously reported financial results may be impossible.

CRITERIA FOR ADJUSTMENTS DISCUSSED:

The adjustments discussed with current senior management did not include all adjustments which might pertain to and materially impact the reported financial information of quarters other than those in which they were recorded. The only adjustments which were discussed were those which met the following criteria:

A. They impacted the consolidated operating results by more than $100,000 and appeared to be other than normal, recurring closing entries and accruals, and

B. They were recorded either:

(1) in conjunction with the year-end or interim quarter-end consolidation process, or

(2) at year-end on the books of a component whose recorded fourth quarter impact on consolidated net loss exceeded by more than $500,000 the average quarterly impact on operating results recorded for the earlier nine months of the year.

Transactions and adjustments other than those considered in our discussions may pertain to and materially affect the operating results reported for quarters during fiscal 1978 other than those in which they were recorded. However, the identified adjustments below account for approximately two-thirds of the loss reported in the fourth quarter.

ADJUSTMENTS ON WHICH OUR CONCLUSIONS ARE BASED:

Of the adjustments, selected using the above criteria and related data discussed, the following adjustments form the basis for our conclusions:

A. The J. M. Fields subsidiary recorded a loss of approximately $25,000,000 in the fourth quarter. Through the first three quarters of the year, the subsidiary's recorded contribution to reported consolidated net earnings was $3,400,000. In their March 9, 1979 report on examination of the consolidated financial statements, Laventhol & Horwath discussed a breakdown of J. M. Fields internal accounting controls as follows:

> "The system of internal accounting controls of the Company's discount department store subsidiary developed serious deficiencies during the year ended July 29, 1978. These systems (which include internal reporting systems and maintenance of accounting records) were inadequate for the purpose of properly recording sales and purchases and maintaining reliable records of accounts payable and inventories. These transactions and amounts enter materially into the determination of financial position, results of operations and changes in financial position. The inadequacies in the system of internal accounting controls made it impracticable for us to carry out sufficient auditing tests and procedures which we deemed necessary to comply with generally accepted auditing standards. Accordingly, there can be no assurance that the aforementioned accounting information is reliable."

B. Imbalances in the intercompany accounts netting $2,300,000 were written off as of July 29, 1978. Reclassification entries reduced accounts payable by $19,000,000, $28,000,000 and $40,000,000 at the end of the first, second and third quarters of fiscal 1978 respectively for the effect of unreconciled intercompany imbalances.

C. Supermarket inventory reserves in the amount of $5,500,000 were established at year-end. No comparable entries were made in connection with interim quarters or at the prior fiscal year-end.

D. Certain deferred charges totaling $2,700,000 were charged off at July 29, 1978.

We would be pleased to discuss further the information contained herein with you at your convenience.

Very truly yours,

TOUCHE ROSS & CO.

ARTICLE XI

INDEMNIFICATION

Except as inconsistent with applicable law, the corporation shall indemnify and hold harmless any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceedings, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director or officer of the corporation or any of its subsidiaries, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or enterprise, or by reason of any action or omission or alleged action or alleged omission by him in such capacity, against all costs, expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent shall not, of itself, create an assumption that the person did not act in good faith and in a manner he reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, have reasonable cause to believe that his conduct was unlawful.

Expenses incurred in defending a civil or criminal action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding as authorized by the Board of Directors in the specific case upon receipt of the undertaking by or on behalf of the person to repay such amount, unless it shall be ultimately determined that he is entitled to be indemnified by the corporation as authorized in this Article.

The indemnification provided by this section shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any applicable statute, By-Law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased serving in such capacity and shall inure to the benefit of the heirs, executors and administrators of such person.

The corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director or officer of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, agent, trustee or fiduciary of, or in another capacity with, another corporation, partnership, joint venture, trust or any other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this Article.

Notwithstanding the foregoing paragraphs, no person shall be entitled to indemnification under this Article in the event such indemnification would in any way relate to actions or omissions that arise from or relate to any financial participation by such person or members of his immediate family in transactions involving conflicts of interest, usurpation of corporate opportunities or other breaches of his fiduciary responsibilities to the corporation. For purposes hereof, members of a person's immediate family shall include his parents, spouse, children, brothers, sisters, grandchildren, first cousins, uncles, aunts, nephews, nieces and their respective spouses.

The provisions of this Article shall apply only to such officers and directors of the corporation who were, on February 23, 1979, in office and any persons who may thereafter serve as officers and directors of the corporation with respect to their conduct in the discharge of their duties for, and on behalf of, the corporation from and after October 2, 1978.

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FOOD FAIR, INC.

Fiscal 1979 Interim Report

For the 28 weeks ended
February 10, 1979

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Twenty-Eight Weeks Ended February 10, 1979

Commission File No. 1-2956

FOOD FAIR, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-1172640
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3175 John F. Kennedy Boulevard, Philadelphia, Pennsylvania 19101

(Address of principal executive offices)

(215) 382-9500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ________ No __x__

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the close of the period covered by this report:

Common Stock, Par Value $1 Per Share, 7,358,277 shares.

FOOD FAIR, INC. AND SUBSIDIARIES
(DEBTOR IN POSSESSION)

FORM 10-Q

INDEX

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

CONSOLIDATED BALANCE SHEETS

FEBRUARY 10, 1979 AND JULY 29, 1978

(in thousands)

NOTE 1

ASSETS

	1979	1978 (Restated, Note 4)
Current assets:		
Cash (includes short term investments of $6,741 in 1979)	$ 50,899	$ 18,604
Accounts receivable, net of allowance for doubtful accounts of $3,125 in 1979 and $2,062 in 1978	25,247	20,017
Inventories	89,420	268,645
Prepaid expenses	5,580	9,265
Assets of closed operations (Note 2)	163,215	—
Assets of discontinued operations (Note 3)	164,993	—
Total current assets	499,354	316,531
Restricted cash (Note 5)	19,675	—
Investments (Note 6)	18,341	14,920
Property and equipment:		
Land	10,282	27,499
Buildings	29,434	90,660
Capitalized leased assets (Note 4)	111,817	362,662
Leasehold improvements	24,815	57,572
Fixtures and equipment	61,282	129,084
	237,630	667,477
Less accumulated depreciation and amortization	114,683	309,424
	122,947	358,053
Other assets:		
Accounts and notes receivable, non-current (Note 12)	10,613	12,984
Deposits and other	7,552	4,850
	18,165	17,834
	$678,482	$707,338

See notes to consolidated financial statements

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

CONSOLIDATED BALANCE SHEETS

FEBRUARY 10, 1979 AND JULY 29, 1978

(in thousands)

NOTE 1

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY IN ASSETS)

	1979	1978 (Restated, Note 4)
Current liabilities:		
Notes payable, secured (Note 7)	$ 45,869	$ 36,685
Current portion:		
long-term debt (Note 8)	43,761	124,954
capitalized lease obligations (Note 4)	151,785	17,304
Accounts payable	29,263	146,078
Accrued salaries and expenses	48,016	47,373
Total current liabilities	318,694	372,394
Liabilities deferred pursuant to proceedings under Chapter XI (Note 9)	336,268	—
Long-term debt (Note 8)	14,940	58,147
Capitalized lease obligations (Note 4)	72,603	224,491
Other non-current liabilities	3,374	3,052
Commitments and contingencies (Notes 12, 14 and 15)		
Shareholders' equity (deficiency in assets): (Notes 10 and 12)		
Preferred stock	1,622	1,627
Common stock	7,557	7,557
Capital in excess of par	51,239	51,239
Deficit	(126,478)	(9,832)
	(66,060)	50,591
Less cost of common stock in treasury	1,337	1,337
	(67,397)	49,254
	$678,482	$707,338

See notes to consolidated financial statements

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

CONSOLIDATED STATEMENT OF OPERATIONS

TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

(in thousands, except per share amounts)

NOTE 1

	Continuing operations	Closed operations	Total
Sales	$554,384	$443,321	$ 997,705
Cost of sales	446,937	385,724	832,661
Gross profit	107,447	57,597	165,044
Operating and administrative expenses	113,948	111,833	225,781
Loss from operations	(6,501)	(54,236)	(60,737)
Other income (deductions):			
Interest, net (Note 8)	(10,502)	(4,456)	(14,958)
Equity in earnings of unconsolidated subsidiaries (Note 7)	2,936	—	2,936
Bankruptcy administrative costs	(1,432)	(1,825)	(3,257)
Other income, net	954	496	1,450
	(8,044)	(5,785)	(13,829)
Loss from continuing and closed operations	$(14,545)	$(60,021)	(74,566)
Loss from discontinued operations (Note 3)			(42,063)
Net loss			$(116,629)
Loss per share of common stock (Note 11):			
Continuing and closed operations			$ (10.13)
Discontinued operations			(5.72)
Net loss			$ (15.85)

See notes to consolidated financial statements

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

CONSOLIDATED STATEMENT OF RETAINED EARNINGS (DEFICIT)

TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

(in thousands)

NOTE 1

	1979
Balance, July 29, 1978 (as previously reported)	$ 27,189
Adjustment for the cumulative effect on prior years of applying retroactively the new method of accounting for leases:	
Company financing leases (Note 4)	(38,784)
Equity in unconsolidated subsidiary financing leases (Note 6)	1,763
Balance, beginning (as restated)	(9,832)
Net loss	(116,629)
	(126,461)
Preferred stock cash dividend paid of $1.05 per share (Note 10)	(17)
Balance, ending	($126,478)

See notes to consolidated financial statements

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

(in thousands)

NOTE 1

	1979
Application of Funds:	
Loss from continuing and closed operations	$ 74,566
Items not affecting working capital:	
Depreciation and amortization	(9,297)
Deferred income	(223)
Equity in undistributed earnings of unconsolidated subsidiaries	2,936
Gain on disposition of property and equipment	614
Working capital provided by continuing and closed operations	68,596
Loss from discontinued operations	42,063
Items not affecting working capital, depreciation and amortization	(2,986)
Working capital provided by discontinued operations	39,077
Total working capital	107,673
Reclassification of long-term obligations to current liabilities applicable to closed and discontinued operations:	
Capitalized lease obligations	134,723
Long-term debt	39,419
Increase in restricted cash	19,675
Reduction of capitalized lease obligations due to disposals	10,754
Current maturities and repayment of long-term obligations	10,199
Purchase of property and equipment	1,477
Increase in working capital	236,523
	$560,443
Source of Funds:	
Liabilities deferred pursuant to Chapter XI proceedings	$336,268
Reclassification of property and equipment of closed and discontinued operations to current assets	220,275
Proceeds from disposition of property and equipment	2,161
Other, net	1,739
	$560,443
Working capital changes—increase (decrease):	
Cash	$ 32,295
Accounts receivable	5,561
Inventories	(179,225)
Prepaid expenses	(3,685)
Refundable income taxes	(331)
Assets of closed operations	163,215
Assets of discontinued operations	164,993
Notes payable	(9,184)
Current portion of long-term obligations	(53,288)
Accounts payable	116,815
Accrued salaries and expenses	(643)
Increase in working capital	$236,523

See notes to consolidated financial statements

FOOD FAIR, INC. AND SUBSIDIARIES
(DEBTOR IN POSSESSION)

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

General:

The accompanying financial statements and footnotes have been condensed and therefore do not contain all disclosures required by generally accepted accounting principles. Reference should be made to the financial statements included in the Company's annual report on Form 10-K, filed with the Securities and Exchange Commission for the year ended July 29, 1978.

The financial statements for the twenty-eight weeks ended February 10, 1979, are unaudited. In the opinion of the Company, all necessary adjustments have been made to present fairly the results of operations for the twenty-eight weeks ended February 10, 1979.

The results of operations are not necessarily indicative of the results to be expected for a full year.

Comparative financial statements at February 11, 1978, and for the twenty-eight weeks then ended are not presented since it is management's opinion that certain adjustments made at the end of fiscal 1978 pertained to the first three quarters of that year and as a result the previously reported unaudited quarterly financial information was inaccurate. It was further determined that any attempt to restate previously reported quarterly results would be impracticable, if not impossible (see Exhibit A). The Company has taken and is continuing to take affirmative action to eliminate any deficiencies in its system of internal accounting controls so as to eliminate such problems in the future. Quarterly comparative financial statements at February 10, 1979, November 18, 1978, and February 11, 1978, and for the periods then ended are not presented due to the items mentioned above and the filing on October 2, 1978, of Petitions for an Arrangement under Chapter XI of the Bankruptcy Act (Note 1) which affected the Company's ability to report financial information at November 18, 1978, and February 10, 1979.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of preparation:

The assets and operations of the closed supermarkets and the discontinued discount general merchandise stores have been segregated in the consolidated balance sheet at February 10, 1979, and in the consolidated statement of operations for the twenty-eight weeks then ended. Included in the closed operations are the assets and operations of closed supermarkets, meat processing and several other support activities. Included in the discontinued operations are principally the assets and operations of the 79 J. M. Fields stores and the footwear departments in those stores.

b. Basis of consolidation:

The financial statements include the accounts of the Company and its wholly and majority owned subsidiaries, except its life insurance company and credit company. All significant intercompany balances and transactions have been eliminated. This elimination at February 10, 1979 necessitated a charge of approximately $300,000 ($2,321,000 at July 29, 1978) to operating and administrative expenses, representing the unreconciled excess of receivables over payables among the Company and its consolidated subsidiaries. Management has taken steps to correct the accounting for intercompany transactions and is continuing to investigate the difference at February 10, 1979.

c. Investments:

Investments in the life insurance and credit companies, 50% owned companies and the common stock of Amterre Development Inc (Amterre) are stated at the Company's equity in net assets. The investment in the preferred stock of Amterre is stated at cost, equal to its liquidating value (see Note 6).

d. Inventories:

Inventories are stated at the lower of cost or market, with cost being determined as follows: inventories in stores—retail method; inventories in warehouses—principally average cost; inventories at manufacturing facilities and supplies—first-in, first-out method.

e. Property and equipment:

Property and equipment is stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets as follows:

Buildings	20–35 years
Leasehold improvements	10–20 years
Fixtures and equipment	3–10 years

Leasehold improvements are amortized over the lesser of the term of the lease or the estimated life of the improvements. Expenditures for maintenance and repairs are charged to operations and major renewals and betterments are capitalized. Costs and related accumulated depreciation of properties sold or otherwise retired have been eliminated from the accounts and gains and losses on disposition are reflected in operations.

See Note 4 for the Company's accounting policy for leases.

f. Pension plans:

Pension expense includes normal cost and amortization of prior service costs over a forty year period.

g. Reclassification:

The balance sheet for 1978 has been reclassified to conform with the presentation for 1979.

1. Chapter XI Proceedings:

As a result of severe liquidity problems caused by unprofitable operations, both prior and subsequent to July 29, 1978, and the failure of suppliers to continue to extend normal trade credit terms, the Company and nine of its wholly owned subsidiaries filed, on October 2, 1978, Petitions for an Arrangement (Petition) under Chapter XI of the Bankruptcy Act (Act) in the United States District Court, Southern District of New York (Court). By order so dated, the Company has been authorized to continue to operate its businesses as Debtor in Possession, subject to the control and supervision of the Court.

The Company is presently formulating a Plan of Arrangement (Plan) which will set forth the proposed terms for payment to creditors. There can be no assurance at this time that a Plan will be accepted by creditors or confirmed by the Court. If such Plan is not accepted and confirmed, the possibilities exist that the Chapter XI proceedings will be transferred to the corporate reorganization provisions of Chapter X of the Act and a trustee appointed or the Company will be adjudicated bankrupt and its assets liquidated.

The financial statements have been prepared on the basis of principles of accounting applicable to a going concern. The continuation of the Company as a going concern is contingent upon, among other factors, its ability to (1) formulate and file a Plan which will gain the approval of the creditors and confirmation of the Court, (2) generate sufficient cash to effectuate the Plan, (3) achieve sustained profitable operations and (4) establish and continue normal trade credit terms with its suppliers. Although there can be no assurances, management believes that the Company has the ability to satisfy these requirements.

2. Closed operations:

Since the commencement of the Chapter XI proceedings, significant changes have occurred in the business and operations of the Company. These principally include the closing of unprofitable supermarkets and support facilities as follows:

Supermarket operation dispositions:

On November 1, 1978, the Court authorized the Company to close 89 supermarkets located in New York and Connecticut. In addition, on January 26, 1979, the Court approved the Company's decision to close its supermarket operations in the Philadelphia and Harrisburg, Pennsylvania, and Tampa, Florida regions, comprising 123 stores.

In connection with the above closings, pursuant to Court approval, the Company liquidated its inventories, sold or is attempting to sell substantially all fixed assets and is in the process of disposing of all lease obligations through disaffirmation or sale of such closed supermarkets. The net proceeds from inventory liquidations aggregated approximately $14,900,000. For the New York and Connecticut supermarkets, as of May 17, 1979, the Company has executed 55 contracts for the sale of leaseholds and related fixtures for approximately $17,000,000 before expenses and has sold 12 properties in which it owns the residual equity interest calling for aggregate proceeds before expenses of approximately $8,700,000 over and above first mortgages aggregating approximately $2,900,000. With respect to the Philadelphia, Harrisburg and Tampa regions, 46 leaseholds were bid upon calling for aggregate gross proceeds before expenses of approximately $25,000,000. In addition to the 212 store closings, the Company has also closed an additional 20 stores in the ordinary course of its business since July 29, 1978. Meat processing activities have also been closed.

Other dispositions

In addition to properties and assets mentioned above, the Company is seeking to dispose of its fee or leasehold interest in over 160 other pieces of real property not presently involved in the Company's ongoing operations. These properties include vacant supermarket locations, warehouse facilities, manufacturing plants, an administrative facility and unimproved real estate located along the eastern seaboard of the United States and in California and the Bahamas. As of February 10, 1979, these properties had an aggregate net book value of approximately $26,800,000 and were subject to mortgages totalling approximately $21,300,000.

All of the various ancillary activities of the Company are being reviewed to determine whether the projected results of their operation over the foreseeable future warrant their retention. This review considers, among other factors, the Company's investment therein, the estimated realizable proceeds upon any disposition, and the Company's overall managerial and systems capabilities and resources.

Management estimates that the proceeds from the disposition of all of the closed operations should be sufficient to substantially recover costs which include fixed asset carrying values, costs incurred to maintain these assets and losses from operations during the phase-out period. As a result, no reserve has been provided, however, the ultimate gain or loss to be incurred upon disposition is subject to significant uncertainties.

FOOD FAIR, INC. AND SUBSIDIARIES

(DEBTOR IN POSSESSION)

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

The detail of assets of closed operations at February 10, 1979, is as follows:

	(in thousands)
Accounts and notes receivable, net of allowance for doubtful accounts of approximately $4,000,000	$ 15,711
Inventories	8,099
Property and equipment, net	63,001
Capitalized leased assets, net (Note 4)	60,480
Deferred costs	13,940
Other	1,984
	$163,215

Non-current assets have been classified as current since it is the Company's intention to dispose of them as soon as possible, although it may take more than one year to complete the disposition. Related liabilities including notes payable, capitalized lease obligations, accrued liabilities and other liabilities and payables are classified as current liabilities to conform with the related asset presentation.

3. Discontinued operations:

On January 26, 1979 the Company decided to dispose of its 79 J. M. Fields general merchandise discount department stores and on April 17, 1979 the Court authorized the Company to discontinue such operations. The Company is presently liquidating the inventories for 45% of their retail value which approximates $106 million. The Company presently estimates that after various expenses and adjustments totaling about $5 million, it should net approximately $42 million on the sale. The loss from operations of discontinued operations for the twenty-eight weeks ended February 10, 1979 is as follows:

	(in thousands)
Sales	$143,842
Cost of sales	128,715
	15,127
Operating and administrative expenses	57,330
Other income	140
Net loss	$ 42,063

Proceeds from the sale of assets, costs incurred to maintain these assets and losses from operations during the phase-out period will be deferred since the Company expects to dispose of these assets on terms sufficient to recover costs. As a result, no reserve has been provided, however, the ultimate gain or loss to be incurred upon disposition is subject to significant uncertainties. The detail of assets of discontinued operations at February 10, 1979 is as follows:

	(in thousands)
Accounts receivable, net of allowances for doubtful accounts of approximately $13,600,000	$ 5,529
Inventories	74,984
Property and equipment, net	21,901
Capitalized leased assets, net (Note 4)	59,801
Prepaid expenses	2,778
	$164,993

Non-current assets have been classified as current since it is the Company's intention to dispose of them as soon as possible, although it may take more than one year to complete the disposition. Related liabilities, including mortgages payable, capitalized lease obligations, accrued liabilities and other liabilities and payables, are classified as current liabilities to conform with the related asset presentation.

4. Change in the method of accounting for leases:

Effective in August 1978, the Company changed its method of accounting for leases as required by regulations of the Securities and Exchange Commission to comply with the provisions of "Statement of Financial Accounting Standards No. 13." This Statement requires the retroactive capitalization of leases and the restatement of financial statements for all years presented. Retained earnings as previously reported at July 29, 1978 has been adjusted for the effect on prior years of retroactively applying the new method of accounting.

5. Restricted cash:

The Company has set up a special trust fund of $25 million authorized by the Court, from the net proceeds of the disposal of real estate, lease rights and equipment and from the liquidation of inventories related to facility closings, as security for credit extended subsequent to October 1, 1978. As of February 10, 1979, $17,527,000 had been deposited in such fund which has earned interest of approximately $240,000.

The Company has deposited $2,148,000 into trust funds to secure payment of an employment agreement with its current president and chief executive officer (Note 15).

6. Investments:

Investments are stated principally at equity in net assets as follows:

	February 10, 1979	July 29, 1978
	(in thousands)	
Amterre Development Inc (a)	$12,127	$ 7,321
Washington Square Life Insurance Company (b)	4,245	4,185
Others	1,969	1,651
	$18,341	$13,157

(a) The Company owns all the preferred stock and 40% of the common stock of Amterre Development Inc.

On June 6, 1978, the Board of Directors of Amterre approved a plan of complete liquidation and dissolution of the Company. A description of the plan is contained in the Company's Form 10-K for the year ended July 29, 1978.

The Company's equity interest in Amterre Development Inc increased by approximately $4,239,000 for the twenty-eight weeks ended February 10, 1979. This increase is a result of the Company's equity interest in the following:

(1) The Company's equity in Amterre's net income is $2,476,000 for the six months ended December 31, 1978, which amount has been adjusted to provide for dividends paid on preferred stock.

(2) During 1978, Amterre changed its method of accounting for leases in order to comply with the provisions of "Statement of Financial Accounting Standards No. 13". Retained earnings, as previously reported at July 29, 1978 has been adjusted by $1,763,000 for the effect of the Company's equity on prior years of applying retroactively the new method of accounting.

Certain dividends on the 6% cumulative preferred stock of Amterre, which is entirely owned by the Company, have not been paid to the Company by Amterre for the three quarters consecutively ending March 31, 1979.

(b) Washington Square Life Insurance Co. (WSL), a wholly-owned subsidiary, provides life, accident and health insurance to the Company's employees and third parties. In addition, WSL administers the Company's basic group life insurance program. In the most recent fiscal year approximately 62% of WSL's annual premium income was derived from employees of the Company and its subsidiaries. The recent supermarket closings and the discontinuance of the general merchandise discount department store operations may have a material adverse affect on WSL, the extent of which cannot be accurately estimated at this time; however, WSL to date has remained profitable and the Company presently intends to retain it.

7. Notes payable, secured:

	(in thousands)
Revolving credit agreement	$28,000
Accounts receivable financing	15,000
Chattel mortgage	2,869
	$45,869

On July 28, 1978, the Company entered into a $28,000,000 revolving credit agreement, with a consortium of banks in which funds drawn bear interest at ½% (2½% upon default) above the prime rate. In August 1978, the Company borrowed the full amount available and on May 25, 1979, the Company paid off the principal plus interest which included a forgiveness of the 2% default provision.

8. Long-term debt:

	Rates	February 10, 1979 (in thousands)	July 29, 1978 (in thousands)	Maturities
Notes:				
Banks (a)	7% to prime plus .5%	$ 55,451	$ 56,563	1979–1982
Other (a)	5% to prime plus .5%	6,502	7,191	1979–1984
Mortgages, land and buildings pledged as collateral	4.75%-10.5%	58,701	60,647	1979–2001
Subordinated debentures (a)	4%	10,350	10,375	1979
Subordinated notes (a)	8.5%	17,000	17,000	1984
Sinking fund debentures (a)	8.38%	31,309	31,325	1996
		179,313	183,101	
Less:				
Current portion		43,761	25,947	
Reclassification of long-term portion upon default (b)		—	99,007	
Reclassification to liabilities deferred pursuant to Chapter XI proceedings (c) (Note 9)		120,612	—	
		$ 14,940	$ 58,147	

(a) Interest ceased to accrue as a result of the Chapter XI filing with respect to all indebtedness of the Company except for notes payable, secured and mortgages.

(b) At July 29, 1978, the Company was in default of certain restrictive covenants in substantially all of the agreements and, accordingly, $99,007,000 of the outstanding long-term portion of the notes and debentures has been reclassified as current.

(c) At February 10, 1979, principally all unsecured long-term debt has been reclassified to liabilities deferred pursuant to Chapter XI proceedings. The remaining long-term debt is applicable to mortgages outstanding of which an additional amount of approximately $38,500,000 has been classified as current since they are attributable to closed and discontinued operations to conform with the related asset presentation.

The Plan of Arrangement currently being formulated, when approved, is expected to result in significant changes in the Company's debt structure. It is not possible to predict the repayment terms of long-term debt which will be included in such Plan.

9. Liabilities deferred pursuant to Chapter XI proceedings:

The liabilities of the Company included in this caption at February 10, 1979 are as follows:

Reclassified from long-term debt (Note 8):

	(in thousands)
Notes payable:	
Banks	$ 55,451
Other	6,502
Subordinated note	17,000
Public debt:	
Subordinated debentures, 4%	10,350
Sinking fund debentures, 8.38%	31,309
	120,612
Notes payable, banks	18,853
Trade payables and other liabilities	199,743
Less amounts offset by banks	(2,940)
	$336,268

10. Capital stock:

The $4.20 cumulative preferred stock, $15 par, is stated at the liquidating value of $100 per share; 108,190 shares are authorized, of which 16,215 and 16,265 are outstanding at February 10, 1979 and July 29, 1978, respectively. The Company is obligated to set aside $120,000 semi-annually as a sinking fund for the redemption of the preferred stock, which may be called for this purpose at $100 per share plus accrued dividends. The decrease in preferred stock represents the stated value of shares retired. As a result of the Chapter XI proceedings, the Company suspended preferred stock dividend payments after the first quarterly payment.

Common stock is $1 par; 10,000,000 shares are authorized, of which 7,557,378 are issued and 199,101 are held in the treasury.

11. Per share data:

Amounts per share are computed based upon the weighted average number of shares outstanding during the period. Shares issuable under employees' stock plans are excluded as their effect is anti-dilutive. Losses per share on common stock for continuing and closed operations are $1.98 and $8.15, respectively.

12. Legal proceedings and contingencies:

The Company and nine of its subsidiaries are presently and have been since October 2, 1978, operating as debtors in possession under Chapter XI of the Bankruptcy Act, under the supervision of the Court. As a result of the filing by such corporations of Petitions for Arrangement under Chapter XI, or as the result of non-payment of various obligations, or both, the Company and various of its subsidiaries are or may be in default under numerous loan agreements, indentures, promissory notes, guarantees, leases of real and personal property, security agreements, mortgages, and other contractual arrangements, including arrangements with labor unions relating to health and welfare contributions, severance pay and pension contributions. The filing of the Chapter XI petitions gave rise to an automatic stay, under Bankruptcy Rule 11-44, of all actions against the filing entities, whether arising out of the foregoing matters or otherwise. It is not presently possible to predict the ultimate outcome of the pending matters described below.

Subsequent to July 29, 1978, the Company has been named a defendant in several class and derivative actions (including a derivative action brought by shareholders of Amterre), the majority of which raise allegations primarily concerning impropriety in dealings with related parties and the issuance of misleading financial information and shareholder communications. At this time, no answers to the allegations have been filed and minimal substantive discovery has taken place. Recovery by plaintiffs could result in the imposition of liability upon the Company subject to a possible right on the Company's part to recover against one or more of the other defendants. The possibility of such recovery or of recoveries from other possible claims against former directors, officers or agents of the Company or others will depend in large part upon the results of investigations currently under way (Note 14).

Accounts and notes receivable, non-current, include amounts which represent the excess of workmen's compensation, automobile and general liability claims and adjustors' fees paid above the deductible amount provided in the related insurance policies. The insurer has denied liability for the claims, and has filed suit seeking to rescind the insurance coverage by alleging misrepresentation of certain information furnished to the insurer prior to issuance of the policies. Counsel for the Company have advised that, on the basis of extensive although not yet complete deposition testimony and other discovery with the principal agents and employees of the insurer, the insurer has not come forward with evidence sufficient to sustain its claim for rescission. The Company has filed counterclaims seeking to recover the excess payments, however, an allowance has been provided in the financial statements at February 10, 1979.

As a result of this litigation, the Company elected new insurance coverage under which it will self-insure individual claims of $100,000 ($250,000 subsequent to July 10, 1978) or less for workmen's compensation, automobile and general liability risks. It cannot be determined whether the Company will be required to make payments to claimants in excess of the amounts accrued, and if so required, whether such amounts will be material. Further, additional liabilities for occurrences may arise as a result of claims not yet filed.

The Federal income tax returns of the Company and certain subsidiaries have been examined by the Internal Revenue Service for 1964 through 1972. The Internal Revenue Service has proposed adjustments which would result in additional taxes of approximately $9,600,000 exclusive of interest.

In December 1978, the State of New York Department of Taxation and Finance issued notices for sale and use taxes due for the period November 19, 1972 through August 31, 1977 in the aggregate amount of approximately $4,500,000, plus interest. It is assumed that New York will file an appropriate proof of claim in the Chapter XI proceedings. The financial statements at February 10, 1979 reflect a provision for additional taxes plus interest.

The Company, as shareholder of Hamilton Advisors', Inc., which served as an advisor to Hamilton Investment Trust, together with others, was named in March 1977, as a defendant in a class action which alleges violations of certain sections of the Federal Securities Laws as well as common law principles. The plaintiffs seek damages of an unspecified and undetermined amount. The defendants have moved to dismiss the complaint; however, the outcome of this litigation is uncertain.

The Company, together with numerous retail food companies and others, has been named as a defendant in multiple civil actions brought in various United States District Courts by certain cattle producers and feeders alleging violations of the anti-trust laws in connection with the purchase and resale of beef.

The cases, which have been consolidated for pre-trial purposes in the United States District Court, Northern District of Texas, seek damages in an unspecified amount and an injunction against further anti-trust violations as alleged. Management believes that no basis exists for the allegations made against the Company and, after consultation with counsel, is of the opinion that these actions will not have a material adverse effect on the financial condition of the Company. These cases are ultimately expected to be tried before a jury.

The Company is party to various other claims and lawsuits arising in the normal course of business, the outcome of which, in the opinion of management, will not materially affect the Company's financial condition.

13. Pension plans:

It is not presently possible to precisely estimate the effect which the closings described in Notes 2 and 3 will have on pension plans administered by the Company. Additionally, the Company may be liable for substantial pension benefits to terminated employees under various collective bargaining agreements. The matter is currently being reviewed by the Company and independent actuaries.

14. Investigation of Transactions with Related Parties:

The Official Creditors' Committees, with the approval of the Bankruptcy Court, have retained independent certified public accountants to perform an investigation of transactions with related parties. This investigation includes, among other things, a review and analysis of transactions between the Company and (1) entities controlled by or related to it or its present and former officers or directors (including entities in which such present and former officers and directors may have an interest), and (2) stockholders of the Company.

The Securities and Exchange Commission has issued an Order of Investigation for the purpose of examining various transactions between the Company and such related or affiliated parties, and to examine the adequacy of the Company's financial reports and disclosures for a period of years prior to the filing of the Chapter XI petition.

It is, at this time, impossible to determine the effects of these investigations, if any, on the financial statements.

15. Commitments:

On January 4, 1979, the Court approved an employment agreement between the Company and its current president and chief executive officer (CEO), under which the Company has paid the CEO $100,000 upon commencement of employment and will pay $350,000 annually for five years. In addition, the Company is obligated, upon termination of the CEO's employment, for annual retirement benefits of approximately $55,000 for the remainder of his or his present wife's life, should she survive him. The Company has also granted him a non-transferable option to acquire up to 200,000 shares of the Company's common stock at $2.00 per share on or before January 2, 1984.

FOOD FAIR, INC. AND SUBSIDIARIES
(DEBTOR IN POSSESSION)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS
TWENTY-EIGHT WEEKS ENDED FEBRUARY 10, 1979

In analyzing the Consolidated Financial Statement of Operations, management believes that consideration must be given to the significantly changed conditions which now exist as a result of the actions taken by the Company, both prior to and following the filing of the Chapter XI petitions. Comparative analysis have not been provided due to the reasons enumerated on page 7 in the general note to the Consolidated Financial Statements. In addition, see Notes 1, 2, 3 and 12 of the Notes to the Consolidated Financial Statements.

The continuing operations of the Company consist principally of the 210 supermarkets located in Florida, Maryland and other southeastern states. Other continuing operations consist of manufacturing support facilities which also sell to outsiders, 10 retail shoe outlets in the eastern part of the United States, footwear importing and distribution and a legal reserve life insurance carrier. Sales of continuing operations comprise 55.6% of the total sales for the period.

The closed operations of the Company consist of the supermarket operations in the New York, Connecticut, Philadelphia and Harrisburg, Pennsylvania and Tampa, Florida areas which accounted for approximately 44.4% of sales.

On April 17, 1979, the court authorized the Company to discontinue its J. M. Fields general merchandise discount store operations, consisting of 79 stores located in the eastern United States. These stores operated at a substantial loss during the past years.

As a result of the filing of the Chapter XI petitions on October 2, 1978, interest expense ceased to accrue with respect to certain indebtedness (Note 8). The non-accrual of interest expense amounted to approximately $5,000,000. In addition, interest income of $837,000 was earned on investments. Other income consists principally of gains on sales of real estate and equipment.

PART II.—OTHER INFORMATION

Item 1. ***Legal Proceedings:***

On October 2, 1978, Registrant and nine of its subsidiaries filed petitions under Chapter XI of the Bankruptcy Act with the Clerk of the United States District Court for the Southern District of New York. Reference is made to Notes 1 and 12 of Notes to the Consolidated Financial Statements herein and the Company's Report on Form 10-K for the year ended July 29, 1978.

Item 9. ***Exhibits and Reports on Form 8-K***

Exhibit A—Touche Ross & Co. letter dated April 25, 1979 relating to a review of certain 1978 fiscal year adjusting entries on previously reported unaudited quarterly financial information.

Forms 8-K

(a) On February 10, 1979, a Form 8-K Current Report was filed relating to the Company's closing of its supermarket operations in the Philadelphia and Harrisburg, Pennsylvania and Tampa, Florida regions on January 26, 1979.

(b) On February 8, 1979, a Form 8-K Current Report was filed relating to an employment agreement with Grant C. Gentry, Chairman of the Board, President and Chief Executive Officer on January 4, 1979.

(c) On November 30, 1978, a Form 8-K Current Report was filed for the month of November relating to the Company's (1) failure to file Form 10-K on a timely manner (2) management changes (3) closing of its supermarket operations in the New York-Connecticut regions.

(d) On October 18, 1978, a Form 8-K Current Report was filed for the month of October relating to the (1) filing of petitions under Chapter XI of the Bankruptcy Act (2) resignations of three directors and (3) continuation of a special audit of related party transactions for the past 5 years.

(e) On September 6, 1978, a Form 8-K Current Report was filed for the month of August, 1978 relating to a special audit as mentioned above.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FOOD FAIR, INC.

(Registrant)

By JOHN T. GRIGSBY, JR.

John T. Grigsby, Jr., Vice President and Chief Financial Officer

By WILLIAM H. MCCHESNEY

William H. McChesney
Vice President and Chief Accounting Officer

June 15, 1979

(Date)

April 25, 1979

Mr. Grant C. Gentry, President
Food Fair, Inc.
Philadelphia, Pennsylvania

Dear Mr. Gentry:

At your request, we have consulted with you and Messrs. McChesney and Grigsby of current senior management as to your determination of the effects of certain fiscal year 1978 adjusting journal entries on reported quarterly financial information within the year 1978. Our basis for consulting with senior management was our discussions of the nature of the adjustments with former financial management and other Food Fair employees and our reading certain documents and analyses and the Company's financial statements as of and for the year ended July 29, 1978, and the accompanying March 9, 1979 report of Laventhol & Horwath, the Company's independent auditors, on their examination thereof. We did not verify underlying data or perform procedures we would consider necessary to review quarterly financial information in accordance with generally accepted auditing standards. An examination of financial statements is normally a prerequisite for such a review, and we have not made such an examination.

CONCLUSIONS:

Based on our discussions and our reading of certain documents including the 1978 quarterly financial statements on Form 10-Q and closing journal entries and underlying analyses for certain journal entries and the conclusions contained in the aforementioned report of Laventhol & Horwath regarding deficiencies in internal accounting control, we have the following observations and conclusions:

A. The deficiencies in internal accounting control during 1978 reported by Laventhol & Horwath were such that there can be no reasonable assurance that 1978 quarterly financial information issued by the Company is reliable. Consistent with the findings of Laventhol & Horwath, we have observed, in the course of our consulting activities, the difficulties experienced by client personnel in attempting to correct or validate information which was prepared in error, apparently because of the same deficiencies.

B. The condition of the system of internal accounting control and the nature and magnitude of the adjustments summarized elsewhere herein signify that material portions of adjustments recorded in the fourth quarter of the fiscal year ended July 29, 1978 pertain to earlier periods.

C. It may not be possible to restate the previously reported quarterly results or the results for the year ended July 29, 1978 since many of the employees who participated in the preparation of the previously issued financial information and underlying accounting records are no longer employed by the Company. In addition, we have been informed by present employees that they frequently are unable to locate documents supporting recorded accounting entries. Also, as a result of the condition of the internal reporting systems and the state of maintenance of the accounting records, Laventhol & Horwath explained in their report that they were unable to perform all of the auditing procedures that they considered necessary to complete their examination of the financial statements as of and for the year ended July 29, 1978. In view of the foregoing factors, we believe reconstruction of available records to appropriately restate previously reported financial results may be impossible.

CRITERIA FOR ADJUSTMENTS DISCUSSED:

The adjustments discussed with current senior management did not include all adjustments which might pertain to and materially impact the reported financial information of quarters other than those in which they were recorded. The only adjustments which were discussed were those which met the following criteria:

A. They impacted the consolidated operating results by more than $100,000 and appeared to be other than normal, recurring closing entries and accruals, and

B. They were recorded either:

(1) in conjunction with the year-end or interim quarter-end consolidation process, or

(2) at year-end on the books of a component whose recorded fourth quarter impact on consolidated net loss exceeded by more than $500,000 the average quarterly impact on operating results recorded for the earlier nine months of the year.

Transactions and adjustments other than those considered in our discussions may pertain to and materially affect the operating results reported for quarters during fiscal 1978 other than those in which they were recorded. However, the identified adjustments below account for approximately two-thirds of the loss reported in the fourth quarter.

ADJUSTMENTS ON WHICH OUR CONCLUSIONS ARE BASED:

Of the adjustments, selected using the above criteria and related data discussed, the following adjustments form the basis for our conclusions:

A. The J. M. Fields subsidiary recorded a loss of approximately $25,000,000 in the fourth quarter. Through the first three quarters of the year, the subsidiary's recorded contribution to reported consolidated net earnings was $3,400,000. In their March 9, 1979 report on examination of the consolidated financial statements, Laventhol & Horwath discussed a breakdown of J. M. Fields internal accounting controls as follows:

> "The system of internal accounting controls of the Company's discount department store subsidiary developed serious deficiencies during the year ended July 29, 1978. These systems (which include internal reporting systems and maintenance of accounting records) were inadequate for the purpose of properly recording sales and purchases and maintaining reliable records of accounts payable and inventories. These transactions and amounts enter materially into the determination of financial position, results of operations and changes in financial position. The inadequacies in the system of internal accounting controls made it impracticable for us to carry out sufficient auditing tests and procedures which we deemed necessary to comply with generally accepted auditing standards. Accordingly, there can be no assurance that the aforementioned accounting information is reliable."

B. Imbalances in the intercompany accounts netting $2,300,000 were written off as of July 29, 1978. Reclassification entries reduced accounts payable by $19,000,000, $28,000,000 and $40,000,000 at the end of the first, second and third quarters of fiscal 1978 respectively for the effect of unreconciled intercompany imbalances.

C. Supermarket inventory reserves in the amount of $5,500,000 were established at year-end. No comparable entries were made in connection with interim quarters or at the prior fiscal year-end.

D. Certain deferred charges totaling $2,700,000 were charged off at July 29, 1978.

We would be pleased to discuss further the information contained herein with you at your convenience.

Very truly yours,

TOUCHE ROSS & CO.

STOCK PRICE DATA

The table sets forth the high and low sales price of the Company's common stock on the New York Stock Exchange for each quarter in fiscal 1977 and 1978 and the portion of the first quarter of fiscal 1979 through October 31, 1978, when the stock was traded on the New York and other stock exchanges. After October 31, the Company's common stock has been traded in the Over-the-Counter Market. The table shows the high-asked and low-bid price quotations reported by the National Quotation Bureau for the portion of the first quarter from November 1 through November 18, 1978, and the second and third quarters of fiscal 1979. The Company's common stock was delisted from the New York Stock Exchange effective October 17, 1978, and suspended from trading in the Philadelphia and Pacific Coast Exchanges effective November 1, 1978.

Fiscal Year	Fiscal quarter ended	High	Low	Dividends
1977	November 20, 1976	5½	4½	5 cents
	February 12, 1977	7⅛	4⅝	5 cents
	May 7, 1977	7⅜	6⅜	5 cents
	July 30, 1977	6⅞	5½	5 cents
1978	November 19, 1977	7⅜	5	5 cents
	February 11, 1978	5½	4¾	5 cents
	May 6, 1978	5¾	4⅝	5 cents
	July 29, 1978	5⅞	4⅝	—
1979	November 18, 1978			—
	July 30-Oct. 31	5⅛	2⅜	
	Nov. 1-Nov. 18	2½	1	
	February 10, 1979	3¼	1⅝	—
	May 5, 1979	4½	1¾	—

Food Fair, Inc.
3175 John F. Kennedy Blvd.
Philadelphia, Pa. 19101